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Ain't No Glory in Pain': How the 1994 Republican Revolution and the Private Securities Litigation Reform Act Contributed to the Collapse of the United States Capital Markets

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“Ain’t No Glory in Pain”:¹ How the 1994 Republican Revolution and the Private Securities Litigation Reform Act Contributed to the Collapse of the United States Capital Markets

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I. INTRODUCTION

In late 1994 and early 1995, the "Republican [R]evolution"² swept through Washington, D.C. and Capitol Hill following the historic 1994

2. See Michael Weisskopf & David Maraniss, *Forging an Alliance for Deregulation: Rep. DeLay Makes Companies Full Partners in the Movement*, WASH. POST, Mar. 12, 1995, at A1, A8 ("During [DeLay's] rise to power in Congress, he had befriended many industry lobbyists who shared his fervor. Some of them were gathered in his office that January [1995] morning at the dawn of the *Republican*

mid-term election.³ This election sweep shifted control of the Congress from the Democrats to the Republicans for the first time in forty years.⁴ The still-faintly-echoing mantra that reverberated in the halls of the Capitol as those newly elected congresspersons took their revolutionary seats was that of “deregulation.”⁵ As a cornerstone of its 1995 agenda for change, the “Revolution Congress”⁶ made deregulation, particularly deregulation of corporate America, one of its primary objectives.⁷ Indeed the Revolution Congress’s leadership felt that the nearly sixty years of “big government” reign, namely federal regula-

revolution, energized by a sense that their time was finally at hand.” (emphasis added)).

3. See Richard Whitt, *Conservative Agenda Will Help America Succeed . . .*, ATLANTA J. CONST., Nov. 18, 1994, at A6 (“Riding the crest of a political tidal wave that carried Republicans to a sweep of Congress last week, U.S. Rep. Newt Gingrich returned home today seeking support from students and business leaders for his conservative agenda. Calling the Republican landslide potentially the most decisive election since the 1932 victory of Franklin D. Roosevelt, Gingrich said the nation must move in a new, conservative direction if it is to survive.”).
4. See Rhodes Cook, *Do the Math, and the Result Is: Not Much of a Contest*, WASH. POST, Oct. 6, 2002, at B3 (“The 1994 election continued this trend, producing the Republican Revolution that ended 40 years of Democratic control of the House and the Senate.”); see also *infra* note 12.
5. See Richard A. Gephardt, *Drive to Deregulate: GOP Congress Paved the Way for Enron and Other Corporate Misdeeds*, SPECIAL REPORT (Democratic Policy Comm.), July 11, 2002, at 1 (“The GOP ‘Contract’ contained a lot of language about accountability and responsibility, when it came to government and welfare mothers. However, it created a double standard coddling corporations. . . . At the time [of the Republican election rout of 1994], the press reported widely on the coming wave of massive deregulation led by House Republicans . . .”). The *Washington Post* reported that following the “Revolution” victory by Republicans, the GOP was planning a “systematic assault on regulation.” Opinion Editorial, *Regulating Regulation*, WASH. POST, Jan. 23, 1995, at A18 (“House Republicans want to impose a six-month freeze or moratorium on federal regulatory activity. The administration is right to call the proposal a clumsy device that would itself create precisely the kind of ‘administrative nightmare’ that its authors claim to deplore.”).
6. The term “Revolution Congress” will refer to the 1995 and 1996 sessions of Congress (104th Congress), commonly referred to as the Republican Revolution of 1994. See *supra* note 2. “Revolution Congress” and “104th Congress” will be used interchangeably throughout this Article.
7. See David Warner, *Putting the Brakes on Federal Rules*, NATION’S BUS., Mar. 1995, at 42 (“Rolling back regulations and heading off potential over-regulation are top priorities in both houses of the 104th Congress.”); see also Gephardt, *supra* note 5, at 1 (“Gingrich called ‘regulation . . . one of the five great enemies that killed the entrepreneurial spirit.’”) (quoting Newt Gingrich). Aiding Speaker of the House Newt Gingrich in the Revolution Congress’s drive to deregulate, Congressman Tom DeLay was equally enthusiastic as the majority whip. DeLay led the stampede to free corporations from virtually all regulations. See Weisskopf & Maraniss, *supra* note 2, at A1. Representative DeLay was so anxious that “[h]e could not wait to start on what he considered the central mission of his political career: the demise of the modern era of government regulation.” *Id.*

tion, as initiated by President Franklin Delano Roosevelt,⁸ and buttressed by the United States Supreme Court since 1937,⁹ had finally

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8. See andré douglas pond cummings, *The Integration Conundrum: Debilitating Failures of the Securities and Exchange Commission Must Be Addressed as U.S. Corporate Malfeasance Is "Getting Serious, So Serious,"* 48 WAYNE L. REV. 1305, 1337-39 (2003) (describing the initiation of the Securities Act of 1933 by President Roosevelt and the Congress as a means to federally regulate the U.S. capital markets following the market collapse of 1929 that led to the Great Depression); see also *infra* notes 54-61 and accompanying text.

In 1933, when Franklin Delano Roosevelt was sworn in as President of the United States, he proposed and Congress enacted into law a series of statutes designed to cure the ongoing economic crisis that had plagued the country since the stock market crash in 1929. See GEOFFREY R. STONE ET AL., CONSTITUTIONAL LAW 166-67 (2001). The goal was to stabilize the economy and ensure that a severe crisis never again would occur. See *id.* at 166. This legislation was known as the New Deal and was unprecedented due both to its size and the swiftness with which it was passed. *Id.* A great portion of the New Deal legislation regulated what citizens, and the federal courts, had previously regarded as private property rights and rights comfortably within the domain of the states. See *id.* at 167.

9. See STONE ET AL., *supra* note 8, at 167. The first federal court challenges to the constitutionality of the New Deal started in 1934. See *id.* The U.S. Supreme Court's initial signals were unclear and mixed. However, in *Railroad Retirement Board v. Alton Railroad Co.*, 295 U.S. 330 (1935), the Supreme Court struck down the constitutionality of the Railroad Retirement Act of 1934. See STONE ET AL., *supra* note 8, at 167. Justice Owen Roberts wrote the 5-4 majority opinion and held that, although Congress had the power to regulate the safety of the railroads, it did not have the power to establish an obligatory retirement and pension plan. *Id.* Only three weeks later in *A.L.A. Schechter Poultry Corp. v. United States*, 295 U.S. 495 (1935), the Supreme Court struck down the constitutionality of the National Industrial Recovery Act of 1933, which was arguably the cornerstone of the New Deal. STONE ET AL., *supra* note 8, at 167-69. In the aftermath of *Schechter*, Congress passed the Bituminous Coal Conservation Act of 1935. However, this statute was struck down by the Supreme Court in *Carter v. Carter Coal Co.*, 298 U.S. 238 (1936). STONE ET AL., *supra* note 8, at 169-73.

In response to these Supreme Court decisions countering his New Deal legislation and his attempt to institute sweeping federal regulation, President Roosevelt proposed changes to the structure of the Supreme Court. See *id.* at 174-75. In 1936, aware of the fact that six Supreme Court justices were over seventy years old, President Roosevelt proposed that for each justice over the age of seventy who did not resign or retire, an additional justice would be added to the Court, totaling fifteen justices if no one left the bench. *Id.* at 175. President Roosevelt wanted to increase the number of justices who would find his New Deal legislation constitutional. The proposal encountered much opposition and was attacked as contrary to the U.S. Constitution, even though the Constitution does not mandate the number of justices that must sit on the high Court. During this debate over President Roosevelt's "court packing" proposal, Justice Willis Van Devanter retired. *Id.* In addition, the Court upheld the constitutionality of a state minimum wage statute in *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937). See STONE ET AL., *supra* note 8, at 175. Most notably, Justice Owen J. Roberts, who had voted with the five-person majority block on the previous issues blocking federal regulatory plans, changed his position and voted to uphold the federal regulation. *Id.* Justice Roberts' change in position has henceforth been known as "the switch in time that saved Nine," because his new position saved

run its course and the time for complete regulatory rollback and reversal had arrived.¹⁰ Many of the Revolution Congress’s leaders believed that extensive federal regulation—of all industries—was an evil that necessarily had to be eradicated.¹¹

the Court’s nine-member composition. *Id.* Following the Court’s rulings in *West Coast Hotel* and *NLRB v. Jones & Laughlin Steel Corp.*, 301 U.S. 1 (1937), the Senate Judiciary Committee rejected President Roosevelt’s “court packing” proposal, because the Supreme Court had signaled approval of the federal regulations that the New Deal offered and would continue to do so, broadening the scope of Congressional Commerce Clause power. Not until 1995, in the Supreme Court decision of *United States v. Lopez*, 514 U.S. 549 (1995), did the now-more-conservative Supreme Court begin decreasing the scope of the federal government’s Commerce Clause power and limiting broad federal regulatory powers. See STONE ET AL., *supra* note 8, 175, 186–97, 199–203.

10. See David M. Shribman, *After Half a Century, the Roosevelt Era Falls to the Republican Revolution*, BOSTON GLOBE, Oct. 1, 1995, at A33. In late 1995 Shribman reported that:

Next week some of the grandees of the capital will gather under the glittering lights of the Sheraton Carlton ballroom. The occasion is a dinner celebrating the “Life, Times and Memorial of President Franklin Delano Roosevelt.” The guest of honor is House Speaker Newt Gingrich.

Politics has its own special dialects, and one of them is irony. And in the last few weeks it has become evident that Speaker Gingrich and the foot soldiers in his Republican Revolution have come to Washington not to praise Franklin Roosevelt but to bury him.

Id. Representative DeLay was so eager to begin his deregulatory crusade that “[e]ven before the new Congress convened . . . [he] assembl[ed] a coalition called ‘Project Relief.’ The Project brought together more than 100 groups (and their lobbyists) behind a very narrow cause: stopping federal regulations of business.” Gareth Cook, *Laws for Sale: Republicans in Congress Let Lobbyists Write Laws*, WASH. MONTHLY, July 1995, at 44. “The honor of serving on Project Relief—and helping to draft the legislation—did not come cheaply, according to a painstaking study of Federal Election Commission (FEC) records by the Washington, D.C.-based Environmental Working Group.” *Id.*

DeLay’s “eagerness” has resurfaced in recent months as the House of Representatives Ethics Committee formally rebuked the Texas Congressperson three times “for conduct that suggested political donations might influence legislative action.” Charles Babington, *DeLay Draws Third Rebuke: Ethics Panel Cites Two Situations*, WASH. POST, Oct. 7, 2004, at A1. “The . . . rebuke marked the second time in six days—and the third time overall—that the ethics panel has admonished [DeLay] The back-to-back chastisements are highly unusual for any lawmaker, let alone one who aspires to be speaker” *Id.* One of the admonishments handed down by the House Ethics Committee “stemmed from a fundraiser DeLay hosted for energy company officials while Congress was considering major energy legislation.” Ted Barrett, *House Ethics Committee Admonishes DeLay Again*, CNN.COM, Oct. 7, 2004, at <http://www.cnn.com/2004/ALLPOLITICS/10/07/delay.ethics/index.html>.

11. See Timothy Noah, *GOP’s Rep. DeLay Is Working in Every Corner To Exterminate Regulations that Bug Business*, WALL ST. J., Mar. 6, 1995, at A16 (“Rep. Tom DeLay once made his living killing roaches. Now he kills regulations.”). Noah stated that when Representative DeLay, the outspoken leader of the Revolution Congress’s effort to effectively rid Washington, D.C. of federal regulation, was asked if there was any existing regulation that DeLay would allow to remain in

A. Deregulation and Reform Hysteria

Congress began its 104th session with an extremely aggressive agenda of "reform," and deregulation styled the "Contract with America."¹² The Revolution Congress first set its deregulatory sights on the securities markets;¹³ second, on the telecommunications indus-

place, "he becomes uncharacteristically hesitant. 'Not that I can think of,' he finally says." *Id.* In August 1995, *Business Week* reported:

The GOP rout of Congress opened hunting season on regulators. . . . Representative Tom DeLay (R-Tex.) compared the EPA to the Gestapo. Days later, Representative David M. McIntosh (R-Ind.) suggested that FDA Commissioner David A. Kessler was killing women. How? McIntosh claimed FDA's ban on some breast implants may be scaring women away from having mammograms.

Harsh words—backed by harsh deeds.

John Carey et al., *The Regulators Rein Themselves In*, BUS. WK., Aug. 21, 1995, at 61.

12. ED GILLESPIE & BOB SCHELLHAS, CONTRACT WITH AMERICA: THE BOLD PLAN BY REP. NEWT GINGRICH, REP. DICK ARMEY AND THE HOUSE REPUBLICANS TO CHANGE THE NATION 3-4 (1994). As described in *Contract with America*:

Election Day, November 8, 1994, was a turning point. America's voters dismantled the forty-year lock the Democrats had on Congress, giving Republicans control of the U.S. Senate and the House of Representatives. For the first time in more than 130 years, a sitting Speaker of the House was defeated for reelection. And despite their ability to wield influence inside the Washington Beltway, two of the most powerful committee chairmen in the House were dethroned by the voters back home.

Nothing written before or after the election better defines the difference between the two parties than the document you now hold in your hands—the *Contract with America*. Rarely has such a meaningful mandate for change been delivered by voters. That mandate is articulated in the common-sense agenda of the *Contract*, the essence of which was presented by Republican candidates six weeks before voters went to the polls and has been much discussed ever since. For the first time in memory, American citizens have a document they can refer to as a means of holding Congress accountable. Returning accountability, and the faith and trust that come with it, was the very reason for creating this *Contract*.

Id. at 3-4; see also Katharine Q. Seelye, *Republicans Plan Ambitious Agenda in Next Congress*, N.Y. TIMES, Nov. 15, 1994, at A1 ("As it rolled out its 'new order' for Congress and the nation, the incoming House Republican leadership announced today that it would force Congress to work 20 hours a day, seven days a week . . . to push through Newt Gingrich's 'Contract With America' in 100 days.").

13. See *infra* sections II.A-E; see also William S. Lerach, *Plundering America: How American Investors Got Taken for Trillions by Corporate Insiders: The Rise of the New Corporate Kleptocracy*, 8 STAN. J.L. BUS. & FIN. 69, 76-77 (2002). Lerach, a preeminent plaintiffs' securities fraud class-action attorney, has written passionately about the frontal assault the Revolution Congress initiated against federal regulation of the U.S. securities markets:

The Republican sweep in 1994 produced the first Republican majorities in both houses of Congress in decades. Republicans—who had years earlier vigorously resisted Roosevelt's efforts to regulate the securities markets, public companies, and the accounting industry—now moved

try;¹⁴ third, on hard-won environmental protections; and fourth, on the energy industry,¹⁵ establishing each as a primary target at which it would aim its early deregulatory firepower.¹⁶ The 104th Congress was gaveled into session with delight¹⁷ by Speaker Gingrich, as the Revolution Congress was certain it had received a mid-term election mandate to end Washington’s “business as usual”—and then set about to “transform” and deregulate the federal government.¹⁸

quickly to cut back the protections provided to investors by the federal securities laws. Specifically, they sought to curtail securities class action suits by investors that had proved so effective at exposing corporate fraud and holding perpetrators accountable. Sensing their first opportunity in decades to roll back the federal securities laws, the corporate interests, accounting oligopoly, Wall Street bankers and their big law firms descended on Congress with a massive lobbying and public-relations campaign seeking enactment of what came to be known as the Private Securities Litigation Reform Act of 1995

Id. at 76; see also *Face Value: In Praise of Trial Lawyers*, *ECONOMIST*, July 12, 2003, at 60 (noting that supporters of William Lerach “champion him as America’s best hope for corporate reform”). In describing Lerach as the preeminent shareholder lawsuit attorney, *The Economist* reports:

At first, the institutions ignored him. But once the stockmarket bubble had burst, they found Mr. Lerach’s theories of fraud—meticulously detailed schemes of personal enrichment that had the boss talking up the share price, cashing in his stock options, then letting the whole artifice collapse with a profit warning or a big write-off—suddenly, and shockingly, credible.

Id.

14. See *infra* section III.A.

15. See *infra* section III.B.

16. See Gephardt, *supra* note 5, at 2–4.

17. See Richard S. Dunham & Mary Beth Regan, *Let the Wild Rumpus Start!*, *BUS. WK.*, Jan. 16, 1995, at 28 (“On Jan. 4, when Speaker Newt Gingrich gaveled the first Republican-controlled House of Representatives in 40 years to order, he ushered in a new era for American business. . . . Executives of companies big and small are chanting the same mantra: Slash spending, cut taxes, eviscerate government regulation.”); see also Cook, *supra* note 10, at 44 (“Washington state’s Republican Senator Slade Gorton was as eager as a six-year-old with a brand-new toy.”); Kenneth Cooper & Helen Dewar, *For Most Republicans on Hill, Last Week Was Like No Other*, *WASH. POST*, Nov. 20, 1994, at A8 (“Something that hasn’t happened in about 40 years happened last week on Capitol Hill: House Republicans talked and everyone listened.”); Richard Dunham, *The House Enforcer Isn’t Blinking*, *BUS. WK.*, Oct. 2, 1995, at 73 (“House Majority Whip Tom DeLay is a happy warrior. As chief vote-counter and head-knocker for the GOP revolution, the Texas Republican spends each day leading his troops into battle to claim what he calls ‘the fruits of our victory.’”); *supra* note 10.

18. See Seelye, *supra* note 12, at A1 (“Flush with their new-found gains, which give them control of the House for the first time in four decades, the Republicans rejected the word ‘transition’ as too narrow for the scope of their endeavor . . . calling it instead a ‘transformation.’ ‘Transition would be when you trade keys—you give me your keys, I’ll give you my keys,’ said Representative Jim Nussle, Republican of Iowa, who was named chairman of the changeover. ‘Transformation is really a redesign and renewal of the administrative and legislative processes.’”); see also Stan Crock & John Carey, *A GOP Jihad Against Red Tape*, *BUS. WK.*,

Early Revolution Congress's deregulatory and reform efforts laser-focused on the federal securities laws that, after intense lobbying, infighting, hand wringing, and doom-saying,¹⁹ led to the passage of the Private Securities Litigation Reform Act of 1995 ("PSLRA").²⁰ In an effort to relieve the securities markets of burdensome federal government oversight, a bipartisan Congress easily passed the PSLRA and handily overrode a President Bill Clinton veto.²¹ The PSLRA dramatically changed the landscape of federal securities law regulation by amending the Securities Act of 1933 ("1933 Securities Act")²² and the Securities Exchange Act of 1934 ("1934 Securities Exchange Act")²³ to essentially, as many argue, "shield corporations and accountants from shareholder lawsuits."²⁴ But the PSLRA did far more (or worse) than shield corporations and corporate insiders from shareholder lawsuits, as detailed *infra*.²⁵

Following the immense reform "victory" of the PSLRA, the Revolution Congress immediately turned its attention to the telecommunications industry as its next deregulation target.²⁶ This deregulatory

Nov. 28, 1994, at 48 ("In early November [1994] the Clinton Administration's regulatory juggernaut—from trustbusters to drinking-water overseers—was running full tilt. But the Republicans' stunning election victory may soon produce something far different: a GOP jihad against federal red tape."); *supra* note 17.

19. See *infra* notes 115–24 and accompanying text.

20. Private Securities Litigation Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737.

21. See 141 CONG. REC. 38,354 (1995); see also *infra* notes 119–20 and 123–24.

22. Securities Act of 1933, 15 U.S.C. §§ 77a–77bbb (2000).

23. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78lll (2000).

24. See Gephardt, *supra* note 5, at 5.

25. See *infra* section II.D.

26. See Jeanne Cummings et al., *Securities Threat: Bush Crackdown on Business Fraud Signals New Era*, WALL ST. J., July 10, 2002, at A1 ("[T]he most notorious [fraud-plagued corporations] have exploded in sectors deregulated in the 1990s: Enron Corp. and its competitors in electricity and energy trading and WorldCom Inc., Global Crossing Ltd., and Qwest Communications International Inc. in telecommunications."). In truth, "commentators are pointing out that the major corporate scandals being played out currently are in industries that were deregulated by Congress in recent years, such as telecommunications (WorldCom) and energy (Enron)." cummings, *supra* note 8, at 1372 n.324. "The depth of the scandals in companies whose industries were deregulated in the 1990s continues to amaze." *Id.* The *Wall Street Journal* further reports that when President George W. Bush gave a "tongue-lashing" to malfeasant big business executives as he prepared to sign the Sarbanes–Oxley Act, these executives were in fact the same big business executives that he had wooed prior to his 2000 election with promises of an administration that would scale back federal interference in their affairs. See Cummings et al., *supra*, at A1.

Perhaps President Bush should direct the "tongue-lashing" to those in his own Administration as well. In a bewildering revelation, Republican-appointed Pentagon officials recently began developing and implementing a futures market scheme involving the investment of money in "terrorism and assassination" contingencies. See Paul Courson & Steve Turnham, *Amid Furor, Pentagon Kills Ter-*

attention evolved into the Telecommunications Act of 1996 (“Telecommunications Act”).²⁷ Passed with wide support and signed into law by a clearly supportive President Clinton, the Telecommunications Act dramatically altered the landscape of federal telecom regulation by overhauling the Telecommunications Act of 1934,²⁸ amending federal law essentially to rewrite longstanding federal laws affecting cable television, telecommunications, and the Internet. “The Telecommunications Act of 1996 is the first major overhaul of telecommunications law in almost 62 years. The goal of this new law is to let anyone enter any communications business—to let any communications business compete in any market against any other.”²⁹ The Telecommunications Act deregulated five major industry categories: radio and television broadcasting, cable television, telephone services, internet and on-line computer service, and telecom equipment manufacturing.³⁰ But, the

rorism Futures Market, CNN.COM, July 30, 2003 (“Facing an outcry on Capitol Hill, the Pentagon on Tuesday [July 29, 2003] killed a program that would have had investors betting on the likelihood of terrorist attacks and assassinations.”), at <http://www.cnn.com/2003/ALLPOLITICS/07/29/terror.market/index.html>. The AP reported that:

[t]he little-publicized Pentagon plan envisioned a potential futures trading market in which speculators would wager on the Internet on the likelihood of a future terrorist attack or assassination attempt on a particular leader. A Web site promoting the plan already is available. When the plan was disclosed by two Democratic senators Monday, the Pentagon defended it as a way to gain intelligence about potential terrorists’ plans. Sen. Hillary Rodham Clinton said she was appalled to hear of plans to set up “a futures market in death.” Other Democrats expressed similar alarm. “The idea of a federal betting parlor on atrocities and terrorism is ridiculous and it’s grotesque,” said Sen. Ron Wyden one of two lawmakers who disclosed the plan Monday.

Plan for Terror Market Canceled, CNN.COM, July 29, 2003, at <http://www.cnn.com/2003/US/07/29/terrorist.market.ap/index.html>.

The Pentagon will abandon a plan to establish a futures market to help predict terrorist strikes, the chairman of the Senate Armed Services Committee said Tuesday [July 29, 2003]. Sen. John Warner said he spoke by phone with the program’s director, “and we mutually agreed that this thing should be stopped.”

Id.

27. See 47 U.S.C. § 153 (2000).

28. Telecommunications Act of 1934, ch. 652, 48 Stat. 1064.

29. See FED. COMMUNICATIONS COMM’N, TELECOMMUNICATIONS ACT OF 1996, at <http://www.fcc.gov/telecom.html> (last modified Mar. 29, 2004). “The Telecommunications Act of 1996 has the potential to change the way we work, live and learn. It will affect telephone service—local and long distance, cable programming and other video services, broadcast services and services provided to schools.” *Id.*

30. Fritz J. Messere, *U.S. Policy: Telecommunications Act of 1996*, at <http://www.museum.tv/archives/etv/U/htmlU/uspolicyt/uspolicyt.htm> (last visited Aug. 29, 2003).

Telecommunications Act did far more (or worse) than attempt to stimulate competition in the telecommunications market.³¹

After the massive deregulatory and reform “victories” of the PSLRA and the Telecommunications Act, the Revolution Congress took aim at the electricity, energy, and derivatives trading industries in its effort to continue to roll back federal regulation.³² Motivated by recent successes in the securities and telecom industries, Congress continued its aggressive efforts to privatize and remove federal oversight from other highly regulated fields.³³ Such aggressive efforts eventually led to the Commodity Futures Modernization Act of 2000 (“CFMA”).³⁴ The CFMA dramatically distorted the energy derivatives trading landscape by refusing the opportunity to regulate energy derivatives trading leading to unregulated energy derivatives trading in wildly fraudulent and dishonest ways.³⁵ The CFMA did far more (or worse) than fail to regulate the energy derivatives trading market, bowing to intense lobbying from the likes of Enron and El Paso.³⁶

The success of the Revolution Congress in discarding or eliminating significant segments of federal regulation from crucial industries was accompanied simultaneously by a wild bull market that saw the U.S. market indicators soar to record heights never before attained.³⁷

31. See andré douglas pond cummings, *How the Telecommunications Act of 1996 and Other 1990's Deregulation Facilitated the Market Crash of 2002: Still "Ain't No Glory in Pain"* (May 2005) (unpublished manuscript, on file with author and available in the Schmid Law Library at the University of Nebraska College of Law). Careful analysis of the Telecommunications Act is beyond the scope of this Article.

32. See Cummings et al., *supra* note 26.

33. See Crock & Carey, *supra* note 18 (detailing the agencies that faced immense regulatory rollbacks at the hands of the Revolution Congress including the Equal Employment Opportunity Commission (“EEOC”), the Environmental Protection Agency (“EPA”), the Food and Drug Administration (“FDA”), the Federal Trade Commission (“FTC”) and the Occupational Safety & Health Administration (“OSHA”), amongst dozens of other agencies and industries).

34. See Pub. L. No. 106-554, § 1(a)(5), 114 Stat 2763, 2763 (2000).

35. See *id.*

36. See cummings, *supra* note 31. Careful examination of the CFMA is beyond the scope of this Article.

37. See Peter Grant & Esther Gross, *Dow Shoots to a Record High*, DAILY NEWS, Nov. 24, 1998, at 3 (“The stock market soared into record territory yesterday in a bull stampede that trampled fears the U.S. economy may be heading for a slow-down.”); see also *Investor Optimism Has Stocks Soaring*, CHI. TRIB., Dec. 24, 1998, at B1 (“Holiday cheer swept over Wall Street on Wednesday. . . . Looking forward, solid investor optimism and an absence of negative news promised to ring out the old year on a high note.”); *Swing Low, Swing High: Dow, Nasdaq Have Record Days, After a Troubled Week*, ABCNEWS.COM, Jan. 7, 2000 (available in the Schmid Law Library at the University of Nebraska College of Law) (“The Dow Jones Industrials soared into record territory today after investors brushed off signs of inflationary pressure and a profit warning from Lucent and sent stock sharply higher. The Nasdaq composite, which tumbled earlier this week, recorded its best day in history. According to preliminary calculations, the Dow

The late 1990s and early part of 2000 saw unabashed speculation that the U.S. capital markets could potentially continue the meteoric climb that had become almost expected by U.S. investors.³⁸ Notwithstanding such exuberance, the U.S. capital markets collapsed in 2002.³⁹ Not since Black Tuesday and the stock market crash of 1929 had the U.S. capital markets faltered so astonishingly.⁴⁰

B. Market Collapse

The Great Depression, one of the bleakest economic periods in U.S. history, was precipitated by Black Tuesday⁴¹ and the U.S. stock mar-

Jones industrial average rose 269.30 to close at 11,522.56 topping its Dec. 31 closing record of 11,497.12.”); *Wall St. Romps in Record Day*, *NEWSDAY*, Dec. 24, 1998, at A56 (“The Standard & Poor’s 500 . . . clos[ed] at a record high for the third day in a row, while the technology-rich NASDAQ composite index soared . . . to a record . . . easily passing Monday’s high.”).

38. See Tom Walker, *Market’s Two-Year Washout Teaches Myriad Lessons*, *ATLANTA J. CONST.*, Mar. 17, 2002, at 1G (“Federal Reserve Chairman Alan Greenspan’s 1996 observation that stock market ‘exuberance’ might be ‘irrational’ was a warning. Two years ago this month Wall Street learned how right he was. March 2000 marked the end of the strongest, longest bull market in U.S. history. Just how far the market would fall came as a surprise.”); see also Sandra Guy, *Analysis Finds Flaws in Retail Industry*, *CHI. SUN-TIMES*, Jan. 10, 2003, at 46 (“The slowdown cannot be blamed solely on the Sept. 11, 2001, terrorist attacks The irrational exuberance of stock market investors during the late 1990s drove exaggerated retail growth . . .”).

39. See *infra* notes 46–53 and accompanying text.

40. See *infra* notes 41–45 and accompanying text.

41. See T.H. WATKINS, *THE HUNGRY YEARS: A NARRATIVE HISTORY OF THE GREAT DEPRESSION IN AMERICA* 32 (1999). Describing “Black Tuesday,” October 29, 1929, Watkins writes:

Selling began in earnest at 10:00 A.M. on Monday and continued on into the next day—“Black Tuesday,” October 29. No one had ever witnessed anything like this day of trading. People began to collect under the big brooding statue of Alexander Hamilton in front of the Exchange building as word of what was happening on the Exchange floor drifted like rancid wood smoke through downtown New York. Soon there were ten thousand people in the narrow street. Some took to religion, wandering to sit numbly in the pews of nearby Trinity Church. There was reason enough for prayer. Inside the Exchange, brokers stood on the floor gape-mouthed and weeping while the losses mounted in a frenzy of sales that by closing had surpassed 16.4 million shares. The *Times* industrials had sunk 43 points, obliterating every gain made since the Bull Market of 1929 had begun. Most of the 751 fabulous trusts that had been created since 1927 were ruined, and with them hundreds of thousands of investors.

More than \$10 billion in market value—about \$95 billion in today’s [1999] money—had vanished in a mere five hours of trading. The full scope of the catastrophe would not be known until the following morning, when all the tallies were done, but only fools pretended the wounds were not mortal.

Id. at 32–33.

ket crash of 1929.⁴² During that stock market collapse, the Dow Jones Industrial Average dropped 340 points and lost eighty-nine percent of its value.⁴³ Thousands of U.S. investors lost millions of dollars⁴⁴ as subsequent congressional panels uncovered the fraudulent activity of corporations, underwriters, and executives as the primary cause of the false valuation of collapsing companies, into which investors had poured (and lost) their life savings.⁴⁵

The stock market collapse of 2001–02 has become, some argue, an equally spectacular failure as Black Tuesday and the market crash of 1929.⁴⁶ One commentator urged the adoption of the moniker “Crash of 2002.”⁴⁷ “Ten trading days, 1,360 points off the Dow. Let’s start calling the ‘sell off’ what it is. Let’s call it a panic. Let’s call it a crash. Indeed, after rallying following Sept. 11, the markets topped out in March [2002], and have been careening downward”⁴⁸ During the stock market crash of 2001 and 2002, the Dow Jones Industrial Average dropped approximately 4,550 points from a January 2000 all time

42. See KENNETH S. DAVIS, *FDR: THE NEW DEAL YEARS 1933–1937: A HISTORY* 12 (1986) (“For it was in America, after all, that the worldwide Great Depression had been signaled and triggered by the stock market crash of ’29, itself a manifestation of breakdown in the American mind and character. Everywhere one looked, here in America, was apparent confirmation of the view that capitalism had so totally failed it could never be revived and that the American democracy was going down with it.”); see also cummings, *supra* note 8, at 1332–33 (“[P]rior to the market collapse preceding the Depression, few federal safeguards were in place and available to investors when they were approached with an opportunity to invest in the stock of emerging companies in the early twentieth century. This lack of regulatory safeguards proved to be disastrous as scores of the U.S. investing public lost fortunes during the Great Depression.”).

43. See Lerach, *supra* note 13, at 71 (“But the 1920s bubble burst in late October, 1929. By mid-November, 1929, the Dow plunged to 198 from its September, 1929 high of 381. By July, 1932, the Dow hit forty-one, down 89%. It would not surpass its 1929 high for twenty-five years.”). In fact, “[b]etween September 1, 1929 and July 1, 1932, the aggregate market value of all stocks listed on the New York Stock Exchange . . . had declined from an all-time high of close to \$90 billion to less than \$16 billion” CHARLES J. JOHNSON, JR., & JOSEPH McLAUGHLIN, *CORPORATE FINANCE AND SECURITIES LAW* 1 (1997).

44. See cummings, *supra* note 8, at 1332 nn.72–74.

45. See *id.* at 1332 n.72 (“The floatation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise.”); see also Lerach, *supra* note 13, at 75 (“In the wake of the 1929 Crash, Congress’s Pecorra hearings exposed the rawest kind of self-dealing, abuse and fraud by corporate insiders, Wall Street bankers (coining the term ‘banksters’), and the accounting firms during the 1920s.”).

46. See Justin Lahart, *The Crash of 2002*, CNNMONEY.COM, July 22, 2002, at <http://money.cnn.com/2002/07/19/news/crash2002>. See also cummings, *supra* note 8, at 1306–12.

47. See Lahart, *supra* note 46.

48. *Id.*

high of 11,750 to an October 2002 low of 7,197,⁴⁹ and the U.S. capital markets lost \$7.7 trillion in U.S. market capitalization value.⁵⁰ Millions of U.S. investors lost billions of dollars⁵¹ as, once again, subsequent congressional panels, governmental agencies, and state attorneys general determined that malfeasant activity of corporations and executives was the primary cause of the collapsing companies,⁵² into which investors had poured (and lost) their life savings.⁵³

49. Telephone Interview with Brent Highberger, Vice President, Senior Financial Advisor, Merrill Lynch (Oct. 8, 2003).

50. Lahart, *supra* note 46 ("The Dow is down 25 percent since then; the S&P 500 is down 27 percent, and the Nasdaq is down 32 percent. And the continuation of selling on Monday, following the seventh worst point-loss in Dow history, is doing little to reassure investors that the worst is over. People worry that, with \$7.7 trillion knocked off U.S. market capitalization since March 2000 (\$750 billion in the past week alone!), the selling will bleed into the economy, not just snuffing the recovery but sending the country into a deflationary episode like the one Japan labors under. Or like the United States strained under in the 1930s.").

51. *See id.*

52. *See cummings, supra* note 8, at 1368 n.314, 1371 n.320, 1372 n.323 (detailing the various charges being levied against criminal corporate executives by the SEC and various state attorneys general). Unquestionably, the tragic events of September 11, 2001 ("9/11") had a crippling, albeit temporary, impact on the U.S. capital markets. *See* E.S. Browning, *Stock Prices Gain, Reaching Levels Unseen Since 9/11*, WALL ST. J., Jan. 27, 2004, at A1 ("Stocks soared to levels that haven't been seen since before the Sept. 11, 2001, terrorist attacks."). The markets had recovered significantly by early 2002, when news of corporate scandals began to hit investors at a dizzying pace, leading to one of the largest selloffs in modern history. *See id.* ("After that whole process with 9/11 and then the corporate scandals that followed, companies tightened their belts," said Todd Leone, head of listed stock trading at brokerage firm SG Cowen in New York. "Today, they are a lot leaner, productivity is a lot better. Companies are doing better with fewer people.").

53. *See* Kirstin Downey, *Restitution Sought from Enron Officials*, WASH. POST, June 27, 2003, at E1 ("Former Enron Corp. executives, including chairman Kenneth L. Lay, chief executive Jeffrey K. Skilling and the company's directors, failed to protect 20,000 workers' and retirees' savings and should pay restitution, the Labor Department contended yesterday in a lawsuit. . . . 'Lay went so far as to tout company stock as a good investment to employees even after he had been warned that a wave of accounting scandals was expected to engulf the corporation. . . . They said nothing, they did nothing to protect' workers, even as they were selling Enron stock themselves. . . . 'Workers at many other companies were hurt as badly or almost as badly as at Enron,' including those at WorldCom Inc., Global Crossing Ltd., Williams Cos. and Dynegy Inc."); *see also* Kate Berry, *Global Crossing Top Brass May Get Off Hook in Civil Suits: Will Justice Be Served?*, L.A. BUS. J., Aug. 25, 2003, at 1 ("Former employees, shareholders and bondholders of Global Crossing, Ltd. are nearing a broad settlement of all civil litigation filed against the bankrupt telecommunications firm, its co-founder, Gary Winnick, and 32 former officers and directors. . . . The amount of the potential settlement represents a fraction of the money lost by investors and employees when Global Crossing filed for Chapter 11 bankruptcy protection in January 2002."). Berry further reports:

Many former Global Crossing employees found their 401(k) retirement plans, loaded with Global Crossing shares, had become worthless.

When the U.S. capital markets collapsed in the late 1920s and early 1930s, various estimates concluded that fully half (50%) of the stock issued in the decade previous to the Great Depression had no value and was proven worthless.⁵⁴ Prior to the 1929 market crash, very few federal safeguards were in place and available to investors when they were approached with an opportunity to invest in the stock of emerging companies.⁵⁵ This lack of regulatory safeguards proved to be disastrous, as thousands upon thousands of U.S. investors lost fortunes during the Great Depression.⁵⁶ As the nation staggered from the effects of the market collapse and Depression, President Roosevelt and the U.S. Congress decided that the U.S. capital markets had to be safeguarded through congressional federal regulatory enactment.⁵⁷

Others were promised severance packages that were terminated when the company filed for bankruptcy protection in 2002, even though lump-sum payouts were given to top executives.

"We literally have thousands of people who lost their savings, their jobs and their severance and health coverage."

Id.

54. "[S]ome \$50 billion of new securities had been floated in the United States during the decade following World War I, of which fully half had proved to be worthless." JOHNSON & McLAUGHLIN, *supra* note 43, at 2 (citing H.R. REP. NO. 73-85, at 2 (1933)). The House of Representatives committee placed much of the blame of the market crash, "unique in financial history," squarely on the securities industry. *See id.* (citation omitted). The House committee reported:

[t]he floatation of such a mass of essentially fraudulent securities was made possible because of the complete abandonment by many underwriters and dealers in securities of those standards of fair, honest, and prudent dealing that should be basic to the encouragement of investment in any enterprise. Alluring promises of easy wealth were . . . made with little or no attempt to bring to the investor's attention those facts essential to estimating the worth of any security.

Id. (citing H.R. REP. NO. 73-85, at 2).

55. *See id.* at 2 ("Securities regulation had been the exclusive province of the states. This had been the case since 1911 when the first blue sky law was enacted in Kansas. In the aftermath of the crash, however, state securities laws were perceived to be inadequate, resulting in growing pressure for regulation on the Federal level.").

56. *See id.* at 1. Referring to the enormous loss suffered by investors due to the market crash of 1929, Johnson & McLaughlin report:

Between September 1, 1929 and July 1, 1932, the aggregate market value of all stocks listed on the New York Stock Exchange . . . had declined from an all-time high of close to \$90 billion to less than \$16 billion, a loss to which, in the words of the Senate Banking and Currency Committee, "the annals of finance present no counterpart."

Id.

57. *Id.* at 3. One of the first things President Roosevelt did upon being inaugurated in 1932 was call upon Congress to create remedial legislation that would protect U.S. investors:

I recommend to the Congress legislation for Federal supervision of traffic in investment securities in interstate commerce.

In spite of many State statutes the public in the past has sustained severe losses through practices neither ethical nor honest on the part of many persons and corporations selling securities.

"The U.S. investing public needed to be protected from unscrupulous sellers and fraudulent issuers of securities whose duplicity had precipitated the Depression."⁵⁸ To protect U.S. investors, the Executive drafted, and Congress debated and eventually passed the 1933 Securities Act, which evolved ultimately into an act of disclosure,⁵⁹ and the 1934 Securities Exchange Act, which extended federal regulation to trading in securities that are already issued and outstanding and also created the Securities and Exchange Commission ("SEC").⁶⁰ President Roosevelt, the New Deal Congress, and the drafters of the 1933

Of course, the Federal Government cannot and should not take any action which might be construed as approving or guaranteeing that newly issued securities are sound in the sense that their value will be maintained or that the properties which they represent will earn profit.

There is, however, an obligation upon us to insist that every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public.

Id. (quoting H.R. REP. NO. 73-85, at 1-2). The drafting of legislation eventually fell primarily on the shoulders of then-professor Felix Frankfurter, and after a number of revisions and consultations with Wall Street lawyers, the draft legislation became the Securities Act of 1933, officially enacted May 27, 1933. *See id.* at 4.

58. *See cummings*, *supra* note 8, at 1333-34.

59. *See* 15 U.S.C. §§ 77a-77aa (2000). Prominent scholars describe the essential elements of the 1933 Securities Act as consisting of:

(a) mandatory full disclosure in a registration statement filed with the Federal Trade Commission (later the SEC), (b) SEC review during a "waiting period," at the end of which sales could commence, (c) mandatory delivery of a prospectus at or before the delivery of the security, and (d) civil liabilities for untrue statements and for certain omissions.

JOHNSON & McLAUGHLIN, *supra* note 43, at 4. Ultimately, the 1933 Securities Act can best be categorized as a disclosure statute. The principal purpose of the statute, as set forth in its preamble, is to provide "full and fair disclosure of the character of securities sold in interstate and foreign commerce and through the mails. . . ." *See id.* at 6.

60. *See* 15 U.S.C. §§ 78a-78mm (2000). Prominent scholars describe the 1934 Securities Exchange Act as having

established the Securities and Exchange Commission and transferred to it the responsibility for administration of the 1933 Act (which had originally been assigned to the Federal Trade Commission). Other provisions of the Act [a] impose disclosure and other requirements on publicly-held corporations; [b] prohibit various "manipulative or deceptive devices or contrivances" in connection with the purchase or sale of securities; [c] restrict the amount of credit that may be extended for the purchase of securities; [d] require brokers and dealers to register with the SEC and regulate their activities; and [e] provide for SEC registration and supervision of national securities exchanges and associations, clearing agencies, transfer agents, and securities information processors.

DAVID L. RATNER & THOMAS LEE HAZEN, *SECURITIES REGULATION: IN A NUTSHELL* 10-11 (7th ed. 2002); *see also* DAVIS, *supra* note 42, at 362-69 (describing the fascinating process the 1934 Securities Exchange Act endured from conception to enactment).

Securities Act believed that required disclosure of pertinent and crucial business information, including profits, debts, earnings, and potential profitability, would give the investing public protection and—perhaps most importantly—knowledge.⁶¹

Despite overwhelming public support for the passage of federal protective regulation of the securities markets,⁶² the 1933 Securities Act and 1934 Securities Exchange Act were bitterly opposed by many in the securities “industry.”⁶³ Wall Street argued vehemently against passage of federal oversight, claiming that regulation of the free market would retard the ability of the capital markets, and capitalism in general, to properly expand, grow, and develop.⁶⁴ Ignoring, to a de-

61. See JOHNSON & McLAUGHLIN, *supra* note 43, at 3–6. Professor Frankfurter explained the disclosure of information afforded through the 1933 Securities Act as follows: “Unlike the theory on which state blue-sky laws are based, the Federal Securities Act does not place the government’s imprimatur upon securities. It is designed merely to *secure essential facts for the investor, not to substitute the government’s judgment for his own.*” *Id.* at 6 (quoting Felix Frankfurter, *The Federal Securities Act: II*, FORTUNE, Aug. 1933, at 108 (emphasis added)).

62. See DAVIS, *supra* note 42, at 367 (“Yet the ‘people of this country . . . in overwhelming majority’ [are] fully aware that unregulated speculation in securities and commodities had contributed greatly to the ‘terrible conditions of the years following 1929,’ and they would ‘not be satisfied with legislation’ on this matter which did not have ‘teeth in it.’”) (quoting a March 26, 1934 letter from President Roosevelt to Senators Fletcher and Rayburn, who were shepherding the 1934 Securities Exchange Act through the U.S. Senate).

63. See *id.* at 362–68. Perhaps the most hostile opposition to the new federal securities laws were led “by Richard Whitney, the arrogantly aristocratic president of the New York Stock Exchange.” *Id.* at 362. Whitney, and a host of corporate, institutional oppositionists, descended upon Washington, D.C. in 1934 to lobby in strident resistance to the 1934 Securities Exchange Act. See *id.* at 366. Professor Davis highlights the intensity of the “establishment’s” opposition to the imposition of federal regulation upon the securities markets as follows:

Richard Whitney organized and led opposition to the bill.

Within days after Roosevelt’s recommendation of the legislation, the New York Stock Exchange president had formed an *ad hoc* national organization, with committees in key industrial cities, to wage war on Fletcher-Rayburn [precursor bill to the Securities Exchange Act of 1934]. He moved down to Washington for the duration of this war, renting a house from which to direct the struggle, and he was the first of a parade of witnesses who marched against the bill in mental uniform and in perfect emotional step with one another through several weeks of House and Senate committee hearings. Far from being an evil thing, speculation was the very essence of the American Way, the very foundation of the American system, and could not be prevented by statute in any case, since it was “human nature.” Such was the conviction of Richard Whitney; such was the conviction of those who followed him to the witness table.

Id. at 365–66 (citation omitted).

64. See *id.* at 366–68. One opponent charged that the regulatory provisions of the 1934 Securities Exchange Act were “the product of a deep, dark plot to point the nation ‘down the road from Democracy to Communism.’” *Id.* at 368.

gree,⁶⁵ the strident protests from industry insiders, President Roosevelt and the New Deal Congress easily passed sweeping federal regulation of the U.S. capital markets.⁶⁶

The 1933 Securities Act, 1934 Securities Exchange Act, and the battery of federal regulations that were put into place by President Roosevelt and the New Deal Congress⁶⁷ for the express purpose of protecting U.S. investors⁶⁸ sought to strike a delicate balance between investor protection and enhancement of capital formation by U.S. corporations.⁶⁹ The Securities Exchange Commission (“SEC”) has struggled for seventy years, since its lofty origin, to appropriately balance its stated goal of protecting U.S. investors and safeguarding the integrity of the U.S. capital markets⁷⁰ against the constant press of U.S.

65. See *id.* at 366 (“Under intense hostile pressures, and in the knowledge that the White House had not endorsed the stringent requirements of the original bill but had instead evinced a willingness to compromise, Cohen, Landis, and Corcoran [drafters of the 1934 Securities Exchange Act], the last of whom proved to be a remarkably able defender of the bill in Senate and House hearings, again rewrote the measure completely.”).

66. See *supra* notes 57–61 and accompanying text; see also DAVIS, *supra* note 42, at 369 (“Of this final bill there was no floor debate; it was passed through both houses by a large majority. Roosevelt signed it into law on June 6[, 1934].”).

67. See THOMAS LEE HAZEN & DAVID L. RATNER, *SECURITIES REGULATION: CASES AND MATERIALS* 5–6 (6th ed. 2003) (“Federal securities law basically consists of six statutes, enacted between 1933 and 1940, and periodically amended in the intervening years, and one enacted in 1970. They are: Securities Act of 1933; Securities Exchange Act of 1934; Public Utility Holding Company Act of 1935; Trust Indenture Act of 1939; Investment Company Act of 1940; Investment Advisers Act of 1940; [and] Securities Investor Protection Act of 1970.”).

68. See *infra* note 70. One of the many ways the Federal securities laws sought to protect investors was through the creation of the Securities and Exchange Commission: “[T]he mission of this agency, the obsession, is investor protection. It comes above every other consideration.” David Vise, *Guardian of the Investor*, WASH. POST, Sept. 24, 1995, at A12 (quoting then SEC Chairperson Arthur Levitt, Jr.) (emphasis added).

69. See *cummings*, *supra* note 8, at 1322 (“The historical battle that is at the heart of [all securities] problem[s] concerns investor protection (through registration) versus capital formation (and the obstacles that restrict such formation.)”). Professor Cheryl Wade notes that

[t]o prevent the hampering of commerce that results from unnecessary registration, the 1933 [Securities] Act provides a variety of exemptions from registration that relieve issuers of the cost and delay of registration. These exemptions generally reflect a balancing of the 1933 Act’s goal of protecting investors through mandatory registration with its goal of facilitating capital formation, particularly for small issuers.

Cheryl L. Wade, *The Integration of Securities Offerings: A Proposed Formula That Fosters the Policies of Securities Regulation*, 25 LOY. U. CHI. L.J. 199, 200 (1994). Wade concludes that “[i]n pursuing the goal of facilitating commerce, the SEC has not . . . abandoned its goal of investor protection.” *Id.* at 207.

70. See U.S. SEC. & EXCH. COMM’N, *THE INVESTOR’S ADVOCATE: HOW THE SEC PROTECTS INVESTORS AND MAINTAINS MARKET INTEGRITY* (“The primary mission of the U.S. Securities and Exchange Commission (SEC) is to protect investors and maintain the integrity of the securities markets. As more and more first-time

corporations and companies to raise capital, often times quickly, to successfully conduct their business.⁷¹ To this day, the SEC continues to struggle with striking this delicate investor-protection-versus-capital-formation balance.⁷²

Despite this relentless tussle, for the last seventy years the SEC has mostly succeeded in protecting U.S. investors and guarding the integrity of the U.S. capital markets.⁷³ Because of a broad congressional grant of rulemaking authority, the SEC has constantly altered,

investors turn to the markets to help secure their futures . . . these goals are more compelling than ever.”), at <http://www.sec.gov/about/whatwedo.shtml> (last modified Jan. 12, 2005). The SEC states prominently that its primary responsibility is to protect those that invest in the U.S. capital markets. *Id.* The SEC describes its congressional mandate as follows:

The laws and rules that govern the securities industry in the United States derive from a simple and straightforward concept: all investors, whether large institutions or private individuals, should have access to certain basic facts about an investment prior to buying it. To achieve this, the SEC requires public companies to disclose meaningful financial and other information to the public, which provides a common pool of knowledge for all investors to use to judge for themselves if a company's securities are a good investment. Only through the steady flow of timely, comprehensive and accurate information can people make sound investment decisions.

Id.; see also cummings, *supra* note 8, at 1313 n.12.

71. See generally Carl W. Schneider et al., *Going Public: Practice, Procedure, and Consequences*, 27 VILL. L. REV. 1 (1981) (describing the process of raising new capital for emerging businesses through initiating an initial public offering and detailing the attendant timetable and required expenses).
72. See Tamar Frankel, *Regulation and Investors' Trust in the Securities Markets*, 68 BROOK. L. REV. 439, 439–40 (2002). In connection with the constant struggle between appropriate regulation and unfettered capital formation, Professor Frankel observes:

Many an economist and academic have argued that regulation is costly for issuers and financial intermediaries. Regulation, they say, is a barrier to capital formation, that is, to inducing savers to part with their money and invest in securities. I assume that they are correct. Regulation does impose these costs, and the costs can be a barrier to raising capital for issuers.

. . . .
Today, some commentators bemoan what they consider to be excessive congressional regulation, especially from the 1930s. These commentators try to show that this body of regulation was wrong and costly. Yet, in the 1930s or any other period of regulatory activism, few argued against regulation. In fact, issuers and intermediaries sought government regulation. What is interesting is how they sought regulation. On the one hand they clamored for it, and on the other they argued for watering down and restricting the impact of every regulatory provision, fighting all the way to congressional approval.

Id. at 440–41.

73. See Stephen Labaton, *In Stormy Time, S.E.C. Facing Deeper Trouble*, N.Y. TIMES, Dec. 1, 2002, at 1. Prior to the stock market crash of 2002, the SEC was widely considered “one of the brightest stars in the constellation of federal regulatory agencies.” *Id.*

adjusted, and tinkered with federal securities regulations in an effort to meet the ever-changing and fast-paced worldwide economies and dazzling technological advances.⁷⁴ For the most part, since its inception, the SEC has been lauded for its ability to carefully regulate the U.S. capital markets, U.S. corporations, and issuances of corporate securities, while simultaneously permitting U.S. companies to function seamlessly, albeit with some difficulty.⁷⁵ However, the “shining star” of the U.S. federal regulatory constellation has fallen in recent years.⁷⁶ Due to the market crash of 2002, much of the praise and acclaim that had been heaped upon the SEC over the years has dissipated and been replaced with harsh criticism.⁷⁷

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74. See HAZEN & RATNER, *supra* note 67, at 9–10. Hazen and Ratner describe the flexibility and success of the SEC as follows:

Among lawyers, and among students of governmental process, the SEC generally enjoys a high reputation. It has been noteworthy for the level of intelligence and integrity of its staff, the flexibility and informality of many of its procedures, and its avoidance of the political and economic pitfalls in which many other regulatory agencies have found themselves trapped. Its disclosure and enforcement policies have also been credited with making an important contribution to the generally favorable reputation which American corporate securities and American securities markets enjoy, not only among American investors, but also in foreign countries.

Id. But see *infra* notes 76–77 and accompanying text.

75. See *supra* notes 73–75 and accompanying text. Most U.S. publicly traded companies likely would argue that complying with the securities laws disclosure requirements is a most difficult undertaking. See JAMES D. COX ET AL., *SECURITIES REGULATION: CASES AND MATERIALS* 153–54 (4th ed. 2004).
76. See Labaton, *supra* note 73 (“The Securities and Exchange Commission, still reeling from the recent resignation of its chairman Harvey L. Pitt and other top officials, is plagued by problems that go deeper than its leadership difficulties and have undermined its ability to police companies and markets . . .”). Labaton acknowledges that despite its status as “one of the brightest stars” in the federal regulatory constellation, the SEC has been harshly criticized for its breakdowns in the wake of “stunning corporate failures that exposed the severe regulatory shortcomings . . .” *Id.*; see also cummings, *supra* note 8, at 1306 n.3, 1311 n.9 (recounting the hailstorm of criticism levied against the SEC in the aftermath of the market collapse of 2002).
77. See Stephen Labaton, *Government Report Details a Chaotic S.E.C. Under Pitt*, N.Y. TIMES, Dec. 20, 2002, at 1 (“The Securities and Exchange Commission under Harvey L. Pitt was described today as dysfunctional by a government report examining the agency’s selection of a new accounting oversight board.”); see also Thor Valdmanis, *Senate Report Blasts SEC’s Enron Oversight*, USA TODAY, Oct. 7, 2002, at 2B. *USA Today* reports:

The Securities and Exchange Commission is expected to come under renewed criticism with the release today of a congressional report on the SEC’s failure to prevent Enron’s Collapse.

In a letter attached to the 130-page Senate Governmental Affairs Committee staff report, ranking Sens. Joseph Lieberman, D-Conn., and Fred Thompson, R-Tenn., accuse the SEC and Wall Street research analysts of allowing “the greed of a few” at Enron to go “unchecked and unchallenged.”

With an admittedly overworked and underfunded SEC on watch,⁷⁸ chaired by Harvey L. Pitt, a man appointed by the Bush administration and “cozy” with the corporate executives he was to be policing,⁷⁹ the Enron Corporation (“Enron”) perpetrated one of the most daring frauds that has ever been perpetrated on the U.S. investing public.⁸⁰ The collapse of Enron was preceded by a shocking array of deception, malfeasance, avarice, greed, and smoke and mirrors.⁸¹ At the time of Enron’s bankruptcy filing, it was the largest corporate disintegration ever in the history of the United States.⁸² Unfortunately, the scale of

“The investigation revealed a story of systemic and catastrophic failure—a failure of all the watchdogs to properly discharge their appointed responsibilities,” the senators write.

Id.; see also Jeffrey Birnbaum, *It’s Time for Him To Go: The Securities and Exchange Commission Is Desperate for Strong Leadership—And Harvey Pitt Isn’t Providing It*, FORTUNE, Oct. 28, 2002, at 99. While deregulation in the 1990s enabled an environment that led to the massive corporate corruption exposed in 2001 and 2002, the SEC took a simultaneous *laissez faire* approach to federal oversight in the 1990s and under the leadership of Pitt. See *id.* This approach, when exposed, caused many to harshly criticize Pitt and the SEC. See *id.*; see also Mark Maremont & Deborah Solomon, *Behind SEC’s Failings: Caution, Tight Budget, ‘90s Exuberance*, WALL ST. J., Dec. 24, 2003, at A1 (“Testifying last month before a Senate committee examining the mutual-fund scandal, current SEC Chairman William Donaldson admitted his agency hadn’t even been looking for the kinds of abuses that were uncovered by today’s crusading Wall Street cop, New York Attorney General Eliot Spitzer. ‘For too long,’ Mr. Donaldson said, ‘the commission has found itself in a position of reacting to market problems rather than anticipating them.’”). Badly underfunded, the SEC “proved a timid, poorly managed bureaucracy at a time when the markets it polices and frauds it seeks to prevent were increasingly complex.” *Id.*

78. See Gephhardt, *supra* note 5, at 7–8 (showing how the Revolution Congress continually refused throughout the 1990s to appropriately fund the SEC in such a way as to allow it to engage in proper federal oversight).

79. See Valdmanis, *supra* note 77, at 2B (“The [Senate Governmental Affairs Committee] report, stemming from one of several congressional probes into Enron, comes at a difficult time for SEC Chairman Harvey Pitt, whose perceived cozy ties to business have again emerged as an issue.”); see also Birnbaum, *supra* note 77, at 100 (“Pitt came into office in 2001 A lawyer who had represented accounting firms, among other companies, Pitt opposed the heavy-handed government intervention and promised a ‘kinder and gentler’ SEC. But fate conspired to give him a mandate for market regulation that [former Chairperson] Arthur Levitt could only dream of. The corporate malfeasance over the past year has put Pitt in an uncomfortable position: He is a diehard deregulator at a time when more regulation is widely viewed as necessary to prevent future scandals.”).

80. See *infra* section IV.A.

81. See *infra* notes 306–21 and accompanying text.

82. See Marianne M. Jennings, *A Primer on Enron: Lessons From a Perfect Storm of Financial Reporting, Corporate Governance and Ethical Culture Failures*, 39 CAL. W. L. REV. 163, 194–96 (2003) (detailing the causes and effects of the Enron implosion); see also ROBERT BRYCE, PIPE DREAMS: GREED, EGO, AND THE DEATH OF ENRON (2002); BETHANY MCLEAN & PETER ELKIND, THE SMARTEST GUYS IN THE ROOM: THE AMAZING RISE AND SCANDALOUS FALL OF ENRON (2003); REBECCA SMITH & JOHN R. EMSHWILLER, 24 DAYS (2003); MIMI SWARTZ & SHERRON WAT-

Enron’s implosion was to be exceeded by others who, together with Enron, were responsible in part for ushering in the stock market crash of 2002.⁸³

With a labored and economically strained SEC as sentinel,⁸⁴ WorldCom Inc. (“WorldCom”) committed a scandalous deception against the U.S. investing public.⁸⁵ WorldCom executives hid, diverted, and secreted billions of dollars of financial loss in an effort to maintain its value, while misrepresenting the health and vitality of the company to U.S. investors.⁸⁶ Sadly, the WorldCom travesty continues as revelations of fraud and deceit continue to be exposed as the corporation seeks to successfully emerge from bankruptcy as MCI.⁸⁷ WorldCom, together with Enron, must shoulder some responsibility for ushering in the stock market crash of 2002.⁸⁸

With the guardian of investors⁸⁹ on duty, Adelphia Communications Corp. (“Adelphia”) executed an impudent fraud against the U.S. investing public.⁹⁰ Adelphia’s primary executives looted, plundered, and embezzled hundreds of millions of dollars of shareholder value, by using the company as a personal piggy bank and faking the fitness

KINS, POWER FAILURE: THE INSIDE STORY OF THE COLLAPSE OF ENRON (2004); Daniel J.H. Greenwood, *Enronitis: Why Good Corporations Go Bad*, 2004 COLUM. BUS. L. REV. (2004); Faith Stevelman Kahn, *Bombing Markets, Subverting the Rule of Law: Enron, Financial Fraud, and September 11, 2001*, 76 TUL. L. REV. 1579 (2002); John R. Kroger, *Enron, Fraud, and Securities Reform: An Enron Prosecutor’s Perspective*, 76 U. COLO. L. REV. 57 (2005); Steven Schwarcz, *Enron and the Use and Abuse of Special Purpose Entities in Corporate Structures*, 70 U. CIN. L. REV. 1309 (2002).

83. See *infra* sections IV.A–F.

84. See *supra* note 78.

85. See *infra* section IV.C.

86. See *infra* notes 332–46 and accompanying text.

87. See Allan Chernoff, *MCI Hit With Criminal Charges*, CNNMONEY.COM, Aug. 27, 2003 (“WorldCom, now doing business as MCI, currently is in Chapter 11 bankruptcy protection, after an \$11 billion accounting scandal.”), at http://money.cnn.com/2003/08/27/technology/mci_charges/index.htm; *WorldCom Accusations Expand*, L.A. TIMES, Aug. 7, 2003, at C3; see also Andrew Backover, *Judge OKs MCI’s \$750M Settlement of Fraud Charges*, USA TODAY, Aug. 7, 2003, at B1 (“A bankruptcy judge Wednesday approved a record \$750 million settlement of fraud charges against MCI by regulators. But allegations of wrongdoing continue to engulf MCI.”). *USA Today* reports that:

The flurry of allegations and counterclaims is increasing before a Sept. 8 hearing to decide whether MCI, formerly WorldCom, can emerge from the biggest bankruptcy case ever. After the SEC settlement, that’s one of its biggest hurdles to recovering from its \$11 billion accounting fraud.

. . . .
The rivals say MCI improperly avoided millions of dollars in fees to connect calls by laundering phone traffic or disguising its origin.

Id.

88. See *infra* sections IV.A, C.

89. See Vise, *supra* note 68.

90. See *infra* section IV.D.

and veracity of the company to U.S. investors.⁹¹ Thus, Adelphia also should be held partially responsible for ushering in the stock market crash of 2002.⁹²

Global Crossing, Ltd. ("Global Crossing") and Qwest Communications International Inc. ("Qwest") also effectuated shocking façades against the U.S. investing public.⁹³ Global Crossing and Qwest separately buried, screened, and obscured hundreds of millions of dollars of financial loss in an effort to maintain stock price, while feigning a fit and vigorous image to U.S. investors.⁹⁴ Global Crossing and Qwest, together with Enron, WorldCom and Adelphia, should be held responsible, in part, for ushering in the stock market crash of 2002.⁹⁵

In a still unfolding alleged scam, the El Paso Corp. ("El Paso") seemingly foisted a brazen money grab on the U.S. investing public.⁹⁶ In an effort to drive up its stock price and while pretending an honest and sincere concern for its energy clients and its U.S. investors, El Paso likely withheld, inhibited, and fraudulently repressed energy supplies, thereby costing energy-starved states hundreds of millions of dollars.⁹⁷ El Paso, like the others discussed above, can and should be held partially responsible for escorting in the stock market crash of 2002.⁹⁸

The aforementioned corporations have been singled out based on the willingness of each company to engage in astonishing duplicity, particularly in industries that Congress has deregulated since 1995.⁹⁹ However, Enron, WorldCom, Adelphia, Global Crossing, Qwest, and El Paso have ample companionship when identifying corporate malfeasors whose actions triggered the crash of 2002: Tyco International Ltd., Xerox Corp., Rite Aid Corporation, Nicor Inc., Merck & Co., Johnson & Johnson Inc., Sunbeam Corporation, Kmart, Abbot Laboratories, Cendant Corp., General Electric Co., and ImClone Systems, Inc., amongst others, cannot escape blame.¹⁰⁰

91. See *infra* notes 349–52 and accompanying text.

92. See *infra* sections IV.A, C–D.

93. See *infra* sections IV.E–F.

94. See *infra* notes 354–73 and accompanying text.

95. See *infra* sections IV.A, C–F.

96. See *infra* section IV.B.

97. See *infra* notes 322–31 and accompanying text.

98. See *infra* sections IV.A–F.

99. See Cummings et al., *supra* note 26 and accompanying text; see also Cummings, *supra* note 8, at 1372 n.324.

100. See *infra* Part IV; see also Cummings, *supra* note 8, at 1319 ("Nor is the SEC protecting investors from unscrupulous corporate pirates, a list that now includes Enron, WorldCom, Adelphia, Xerox, Rite Aid, Tyco International, Global Crossing, Nicor, Merck, Johnson & Johnson, Sunbeam, ImClone and Qwest Communications, amongst many others.").

The “independent” auditors that each played a primary role in enabling such acts of corporate treachery¹⁰¹ cannot be forgotten when describing corporate malfeasance: Arthur Andersen, Price-waterhouseCoopers, Ernst & Young, KPMG, and DeLoitte & Touche.¹⁰² Neither can the investment banks,¹⁰³ nor the lawyers

101. See cummings, *supra* note 8, at 1309–10 & n.7.

102. See *id.* at 1310 n.7 (“However, Arthur Andersen will likely not be alone now in shouldering accounting firm blame for the astonishing corporate failures of the past two years. Other ‘big-five’ firms—K.P.M.G., Deloitte & Touche and Ernst & Young—now face serious allegations of misconduct and . . . civil action filed against them by state regulators and the SEC.”). KPMG LLP has been harshly criticized for its role in the WorldCom disaster, specifically, “[t]he examiner in MCI’s Chapter 11 bankruptcy case issued a report critical of a ‘highly aggressive’ tax strategy . . . recommended to MCI to avoid paying hundreds of millions of dollars in state income taxes, concluding that MCI has grounds to sue KPMG—its current auditor.” Dennis Berman et al., *MCI Examiner Criticizes KPMG on Tax Strategy*, WALL ST. J., Jan. 27, 2004, at A3. KPMG responded that the “tax strategy used by MCI is commonly used by other companies and called the examiner’s conclusions ‘simply wrong.’” *Id.* “MCI, the former WorldCom, still uses the tax strategy.” *Id.*

103. See *Morgan, Citi to Pay \$305 Million: Wall Street Banks Agree to Settlement To End an Investigation into Their Dealings with Enron*, CNNMONEY.COM, July 28, 2003 (available in the Schmid Law Library at the University of Nebraska College of Law). *CNN Money* reports:

J.P. Morgan Chase & Co. and Citigroup Inc. agreed Monday to pay more than \$300 million to resolve an investigation into charges that the banks helped bankrupt Enron Corp. and another energy trading firm mislead investors. Under the settlement with the Securities and Exchange Commission, J.P. Morgan, the nation’s No. 2 bank, will pay \$135 million and Citigroup, the largest bank ranked by assets, will pay \$120 million. It will allow the banks to avoid prosecution but force them to alter some business practices.

Id.; see Lerach, *supra* note 13, at 114–17 (“But more than anybody else, it was the banks (banksters?) that were behind the colossal frauds at Enron and WorldCom. This still is the largely untold story of these two frauds. . . . So, with the help of their Wall Street banks, Enron and WorldCom raised thirty-three billion dollars in fresh capital from investors in the four years before they both went bankrupt—selling what were ‘investment grade’ rated bonds when issued—but which in short order were worthless! This is probably the greatest bond rip-off in history.”); *SEC Subpoenas Citigroup: Regulators Want to Question Financial Firm on Its Role in Dynegy’s Project Alpha Transaction*, CNNMONEY.COM, May 31, 2002 (“The Securities and Exchange Commission has subpoenaed Citigroup Inc. over its role in a controversial natural-gas transaction that made energy trader Dynegy Inc.’s finances look better than they actually were . . .”), at http://money.cnn.com/2002/05/31/news/companies/citigroup_dynegy; see also Berman et al., *supra* note 102 (“[The MCI bankruptcy examiner] reserve[d] special ire for securities firm Salomon Smith Barney, which the report says doled out more than 950,000 shares from 22 initial and secondary public offerings to ex-Chief Executive Bernard Ebbers for a profit of \$12.8 million.”). Richard Thornburgh, the WorldCom bankruptcy examiner, concluded with respect to investment bank Salomon Smith Barney that the more than 950,000 shares “were intended to and did influence Mr. Ebbers to award” more than \$100 million in investment-banking fees to Salomon, a unit of Citigroup Inc. . . .” *Id.* “Mr. Thornburgh said MCI has grounds to sue both Citigroup and Mr. Ebbers for damages for breach of fidu-

(and their firms) that represented each scandalous corporation,¹⁰⁴ escape blame for facilitating, arguably, the greatest corporate betrayal of U.S. investors in United States history.¹⁰⁵ In a surprisingly under-reported study, Professor Ho Young Lee conducted a systematic analysis of Big Six accounting firms¹⁰⁶ following adoption of the PSLRA examining whether accounting irregularities increased after passage.¹⁰⁷ In a critically important conclusion, Professor Lee found that accruals¹⁰⁸ and auditing irregularities ballooned for the Big Six accounting firms in the years directly following passage of the PSLRA.¹⁰⁹ Accounting irregularities and accruals did not increase, however, for accounting firms not characterized as one of the Big Six.¹¹⁰ This study is crucial for two reasons: First, those that claim that no connection exists between 1990s deregulation, specifically the PSLRA, and the subsequent market collapse of 2002, can hardly proclaim that no connecting evidence exists. Big Six auditor instances of fraud and duplicity skyrocketed following the adoption of the PSLRA. Second, a binding connection between the PSLRA and the market crash of 2002 clearly is formed wherein the role of auditors and accountants cannot be understated. While corrupt corporate executives

ciary duty and good faith." *Id.*; see also Jonathan Weil & Robin Sidel, *J.P. Morgan's WorldCom Risk: Former Underwriter in Scandal May Face High Settlement Costs as Class-Action Suit Draws Near*, WALL ST. J., Mar. 11, 2005, at C1 ("Investors allege that the former bond underwriters, including J.P. Morgan, failed to adequately investigate the company's financial health when they sold \$17 billion of WorldCom bonds in 2000 and 2001—shortly before the telecom company . . . slid into bankruptcy amid a massive accounting-fraud scandal.").

104. See Lerach, *supra* note 13, at 113 ("Enron's lawyers also failed miserably These were sophisticated firms, like investment bankers, who held themselves out as having special expertise to help put together the kinds of complex structured financial transactions that created million [*sic*] and millions of dollars of false profits for Enron.").
105. See *supra* notes 46–53 and accompanying text.
106. In 1995, the Big Six accounting firms referred to Pricewaterhouse, Arthur Andersen, KPMG, Deloitte & Touche, Coopers Lybrand, and Ernst & Young. Since 1995, Pricewaterhouse merged with Coopers Lybrand forming PricewaterhouseCoopers, and Arthur Andersen ceased to exist following the corporate scandals of 2002.
107. See Ho Young Lee & Vivek Mande, *The Effect of the Private Securities Litigation Reform Act of 1995 on Accounting Discretion of Client Managers of Big 6 and Non-Big 6 Auditors*, 22 AUDITING: J. PRAC. & THEORY, Mar. 2003, at 93, 93–105.
108. An accrual is defined as "the recognition of revenue when earned or expenses when incurred regardless of when cash is received or disbursed." VENTURELINE, ACCOUNTING DICTIONARY, at http://www.ventureline.com/glossary_A.asp (last visited Mar. 21, 2005). The accrual basis of accounting is "where[] revenue and expenses are recorded in the period in which they are earned or incurred regardless of whether cash is received or disbursed in that period. This is the accounting basis that generally is required to be used in order to conform to generally accepted accounting principles (GAAP)" *Id.*
109. See Lee & Mande, *supra* note 107, at 99–105.
110. See *id.*

receive their fair share of blame and ire, the accountants that enabled the duplicity must now share that limelight. Third, when regulation and federal oversight is removed, many corporate executives and professional auditors cannot be counted on to act nobly.

Simply stated, because of U.S. corporate management's dishonesty and willingness to engage in fraud and deception, trillions of dollars were lost by U.S. investors¹¹¹ and thousands of employees' lives were ruined due to the loss of employment¹¹² and the decimation of retirement accounts.¹¹³ In light of the preceding introduction to the deregulation and reform hysteria that gripped the Revolution Congress and

111. See David Greising, *Enough Already: Reform Now, from the Top*, CHI. TRIB., June 9, 2002, at C1 (detailing the surge in corporate scandals resulting in related stock plummet). While reporting on the recent accounting failures and falsifications of such companies as Kmart, Abbot Laboratories, Cendant Corp., and General Electric, Greising notes "[t]here was a time when all it took to follow business was a good eye for strategy and a good head for numbers. Now we need a good nose for a scandal and a strong stomach for indigestion. . . . By some estimates, investors have lost \$4 trillion in market value in scandal-related stock drops." *Id.*

112. See Diane E. Lewis, *More Layoffs Likely for Firms Under Fire*, BOSTON GLOBE, July 7, 2002, at G2 ("Enron reduced its staff by 4,000 after it was forced to restate its earnings, reports Challenger, Gray & Christmas, an outplacement firm that tracks layoffs. Thus far, 8,000 Andersen workers have been impacted, and WorldCom is expected to cut 17,000. Meanwhile, workers at Tyco lost 15,000 jobs in February."). The *Boston Globe* further reports:

"We will likely continue to see more jobless fallout from these firms as well as other companies under fire," said John Challenger, chief executive of the Chicago-based firm. "The lapses in corporate ethics not only affect employees, but entire communities end up suffering as unemployment rises and consumer spending falls."

. . . "Already, there have been about 1,000 companies that have revised their profit numbers The Bush administration is trying to limit the damage (from the accounting scandals here) to a few bad apples, but it is much more widespread than that. Not all the companies will go under, but this whole thing, from the viewpoint of people overseas, looks like a nightmare."

Id.

113. See *supra* note 53; see also *Enron Workers Went Down with Ship*, CBSNEWS.COM, Jan. 14, 2002 ("Thousands of Enron employees lost their investments, savings and retirement portfolios in the collapse of the energy trading giant. Congressional committees as well as the Justice and Labor departments want to know why many senior Enron executives and board members sold their stock when it was still valuable, while workers were barred from selling stock in their 401(k) funds"), at <http://www.cbsnews.com/stories/2002/01/14/national/printable324196.shtml>. *CBS News.com* continued:

Enron employees whose 401(k) accounts were filled with company stock watched helplessly as ceaseless bad news obliterated their value last fall, while a bookkeeping mechanism barred them from cashing out.

"I'll never trust my employer quite the same again," said Tim Dalton, a corporate security specialist who was among the 4,500 Houston workers laid off in December [2001].

Id. See generally Marianne Lavelle & Matthew Benjamin, *The Biggest Bust: Workers and Stockholders Are Enron's Worst Casualties*, U.S. NEWS & WORLD REP., Dec. 10, 2001, at 34 (discussing the consequences of Enron's collapse).

the subsequent description of the market crash of 2002, the following question is irrefutably apparent: Did the deregulation and reform efforts of the Revolution Congress directly cause or lead to the U.S. capital market crash of 2002?¹¹⁴ This Article will look surgically at that question.

First, this Article will carefully examine the PSLRA, noting the investor protections that were stripped from the federal securities laws, and will seek to determine the effect that such stripping had on the securities industry and the individual investor. An examination of the legislative history of the PSLRA will follow, which should reveal whether the dire circumstances actuated by the market collapse of 2002 were in fact forecasted by opponents of the PSLRA.

Second, this Article will examine the market collapse of 2002. Specifically, it will inspect and detail the sources of the enormous failure of each of the primary corporations in each industry outlined above. Determining the source of the corporate fiascos will reveal whether the atmosphere of deregulation initiated by the Revolution Congress ultimately led, in part, to the collapse of the U.S. capital markets in late 2001 and 2002. In particular, the Article will examine the colossal collapses of Enron, WorldCom, Adelphia, Global Crossing, and Qwest, amongst others.

Third, after analyzing whether 1990s deregulation is partially to blame for the stock market collapse of 2002, the Article will examine whether recent congressional proposals, including the Sarbanes–Oxley Act, will in fact fix the problem that deregulation appears to have so quietly introduced. Finally, this Article will conclude by positing that re-regulation of the securities industry must occur to protect against future market destruction by corporate malfeactors. The Article will also rebut those scholars and authors who have suggested, since the collapse of 2002, that re-imposing regulations on the securities and other deregulated industries will not ultimately solve the problems exposed by the recent capital markets failure. Specific re-regulations will be suggested and congressional adoption urged.

II. THE PRIVATE SECURITIES LITIGATION REFORM ACT

As the cornerstone of its deregulation *mêlée*,¹¹⁵ the Revolution Congress passed the PSLRA in 1995 amid much dissension, spectacle,

114. See *infra* sections IV.A–F.

115. See *supra* notes 7, 10–13 and accompanying text. While “deregulation” and “free markets” were mantras for the Republican Revolution, their talk of freedom was highly misleading. The Gingrich Republicans were not interested in creating some fanciful, pristine, abstract “free market.” Such a “free market” has never existed and never will. Rather, through intensive government efforts, they sought to create new market

explicit warning, and ceremony and over a Presidential Veto.¹¹⁶ The PSLRA, to be sure, was a controversial measure,¹¹⁷ one that rolled back portions of federal regulation of the securities industry that had been in place since the 1930s.¹¹⁸ Despite the controversial nature of this deregulation, the PSLRA passed comparatively easily, with some bipartisan support,¹¹⁹ and the Senate comfortably voted to override the President Clinton veto.¹²⁰ The PSLRA, upon passage, was hailed as legislation that would bring sanity and evenhandedness to the se-

rules that were favorable to Enron and a host of other influential corporations. The so-called free market that resulted was not state of nature: It was a highly crafted artifice, coolly manufactured on K Street and on Capitol Hill by the Republican Congress—and in Enron’s case, with the help of Kenneth Lay’s close friend, the new governor of Texas, George W. Bush.

Only one force stood between the Gingrich Republicans and total success: the Clinton White House and the Democrats. Clinton, to be sure, recognized the need to reform old regulatory rules and other laws in accordance with changed economic realities. And the Democrats had plenty of their own connections to K Street. But Clinton and the vast majority of his party also realized that radical deregulation of the sort Gingrich advocated could spell disaster. And now, in the Enron crisis, the disaster has unfolded.

Sean Wilentz, *A Scandal for Our Time*, AMERICAN PROSPECT, Feb. 25, 2002, available at <http://www.prospect.org/web/page.ww?section=root&name=viewPrint&articleId=6141>.

116. See *supra* notes 19–24 and accompanying text.

117. See 141 CONG. REC. 35,260–311 (1995) (recording the volatile debate on the U.S. Senate floor in opposition to the PSLRA).

118. See *supra* notes 19–25 and accompanying text; see also Abner J. Mikva, *Share and Shares Alike: Now Let’s Fix the “Reform” of our Securities Laws*, LEGAL TIMES, Apr. 8, 2002, at 50; Eugene Zelensky, *New Bully on the Class Action Block: Analysis of Restrictions on Securities Class Actions Imposed by the Private Securities Litigation Reform Act of 1995*, 73 NOTRE DAME L. REV. 1135, 1136 (1998).

119. 141 CONG. REC. 35,571 (1995) (recording the House of Representatives Rollcall vote No. 839 that approved the conference report of the PSLRA—320 Yeas to 102 Nays); 141 CONG. REC. 35,304 (1995) (recording the U.S. Senate Rollcall vote No. 589 that approved the conference report of the PSLRA—65 Yeas to 30 Nays).

120. 141 CONG. REC. 38,354 (1995) (recording the Rollcall Vote No. 612 Leg. that overrode President Clinton’s PSLRA veto—68 Yeas to 30 Nays).

curities class-action schema.¹²¹ However, many fiercely disagreed with such hailing.¹²²

President Clinton, in the face of immense political pressure and against the recommendations of many leading Democratic Senators,¹²³ issued his official PSLRA veto statement, returned the legislation without approval, and forecasted the debilitating impact the PSLRA would have on average U.S. investors:

I am returning herewith without my approval H.R. 1058, the "Private Securities Litigation Reform Act of 1995." This legislation is designed to reform portions of the Federal securities laws and to end frivolous lawsuits and to ensure that investors receive the best possible information by reducing the litigation risk to companies that make forward looking statements.

I support these goals. . . . I am not, however, willing to sign legislation that will have the effect of closing the courthouse door on investors who have legitimate claims. Those are the victims of fraud that should have recourse in our courts. Unfortunately, changes made in this bill during conference could well prevent that.

This country is blessed by strong and vibrant markets and I believe that they function best when corporations can raise capital by providing investors with their best good-faith assessment of future prospects, without fear of costly, unwarranted litigation. But I also know that our markets are as strong and effective as they are because they operate—and are seen to operate—with integrity. I believe that this bill, as modified in conference could erode this crucial basis of our markets' strength.¹²⁴

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121. See *infra* notes 127–34. When describing the Congressional environment that accompanied passage of the PSLRA, one commentator notes:

In 1995 Congress set out to fix securities class action litigation when it passed the Private Securities Litigation Reform Act The Reform Act was designed to address a number of perceived abuses in these cases. In large part, its solution was to create a series of procedural hurdles that make it more difficult for plaintiffs' attorneys to bring and maintain nonmeritorious securities fraud class actions.

Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003 U. ILL. L. REV. 913, 914.

122. See *infra* sections II.D–E. (describing the strong opposition to passage of the PSLRA and the forecasts of corporate malfeasance that would ensue upon passage).
123. See Mikva, *supra* note 118. Of President Clinton's decision to veto the PSLRA, Mikva writes:

The PSLRA passed over President Bill Clinton's veto—one of his most politically charged decisions. Many of his strongest supporters in the Senate were sponsors of the bill. While the trial lawyers, key political allies of the president, were vigorously opposed to the legislation, the Silicon Valley crowd, who also had supported Clinton enthusiastically in 1992, were some of the bill's prime movers. Many senior advisers in the White House, who had suffered their own encounters with aggressive lawyers in the private sector, urged him to sign the bill.

Id.

124. President's Message to the House of Representatives Returning Without Approval the Private Securities Litigation Reform Act, 31 WEEKLY COMP. PRES. DOC. 2191, 2210–11 (Dec. 20, 1995) (emphasis added); see also Mikva, *supra* note 118. Mikva adds:

President Clinton was not alone in his assessment that passage of the PSLRA would “have the effect of closing the courthouse door on investors who have legitimate claims” and would, speaking of U.S. market integrity, “erode this crucial basis of our markets’ strength.”¹²⁵ In light of recent events, particularly the crash of 2002, President Clinton and all those in original, strident opposition to the PSLRA, look positively clairvoyant.¹²⁶

A. How the PSLRA Amended Securities Fraud Pleading Requirements

The PSLRA was originally intended to amend the 1933 Securities Act and the 1934 Securities Exchange Act so as to end frivolous securities fraud lawsuits by imposing a number of procedural and substantive hurdles upon securities plaintiffs.¹²⁷ Seeking to once and for all control the problem of “strike suits,”¹²⁸ Congress patched together legislation that created a pleading standard never before contemplated

But in the end President Clinton made the right decision and vetoed the legislation. It was a bold political move to challenge the special interest juggernaut that had captured congressional majorities in both houses. It was also futile: Congress overrode the veto, making the PSLRA law.

Simply put, Congress reduced the incentives against committing fraud.

Id.

125. *See id.*; *see also infra* section II.E.

126. *See generally infra* section II.E (describing the strong opposition to passage of the PSLRA and the forecasts of corporate malfeasance that would ensue upon passage).

127. *See* John W. Avery, *Securities Litigation Reform: The Long and Winding Road to the Private Securities Litigation Reform Act of 1995*, 51 BUS. LAW 335, 335–37 (1996).

128. *See* BARBARA ALLEN BABCOCK & TONI M. MASSARO, CIVIL PROCEDURE: CASES AND PROBLEMS 323 (2d ed. 2001) (“One reason the courts (and many defendants) have been so concerned about pleading burdens in securities fraud cases is the fear of strike suits—baseless suits or suits plaintiffs otherwise doubt they could win but nevertheless file in the hope that defendants will settle to avoid litigation costs. Surviving a motion to dismiss is often the primary—perhaps sole—objective of plaintiff’s counsel, as no further steps often are necessary.”). The United States Court of Appeals for the Second Circuit described what was considered an irresolvable tension prior to passage of the PSLRA:

On the one hand, there is the interest in deterring fraud in the securities markets and remedying it when it occurs. That interest is served by recognizing that the victims of fraud often are unable to detail their allegations until they have had some opportunity to conduct discovery of those reasonably suspected of having perpetrated a fraud. . . .

On the other hand, there is the interest in deterring the use of the litigation process as a device for extracting undeserved settlements as the price of avoiding the extensive discovery costs that frequently ensue once a complaint survives dismissal, even though no recovery would occur if the suit were litigated to completion. It has never been clear how these competing interests are to be accommodated

under the Federal Rules of Civil Procedure, essentially requiring "super heightened"¹²⁹ pleading for securities fraud cases while simultaneously amending numerous provisions of the securities laws to make it exceedingly more difficult for aggrieved investors to bring and/or prevail in a securities fraud lawsuit.¹³⁰ Further, as stated in its enacting language, the PSLRA was initiated to ensure that investors would receive honest, straightforward information by reducing the litigation risk to corporations that made forward-looking statements in their public filings documents.¹³¹ These amendments were thought necessary based on testimony proffered by dozens of U.S. corporate officers decrying the "unbearable" impact that securities fraud lawsuits were having on the conduct of business in the United States.¹³² Corporate officers testified that "frivolous" securities law-

In re Time Warner, Inc. Sec. Litig., 9 F.3d 259, 263-64 (2d Cir. 1993), *cert. denied*, 511 U.S. 1017 (1994); see also Elliott J. Weiss & Janet E. Moser, *Enter Yossarian: How to Resolve the Procedural Catch-22 that the Private Securities Litigation Reform Act Creates*, 76 WASH. U. L.Q. 457, 457 (1998) ("Prompted by significant evidence of abuse in private securities lawsuits, Congress decided that a new set of procedural rules should govern such actions."); Tiffany M. Wong, Comment, *Defendants' Standing To Oppose Lead Plaintiff Appointment Under the Private Securities Litigation Reform Act of 1995*, 2003 U. CHI. LEGAL F. 833, 834 ("Congress perceived that abusive practices were undermining the overriding purposes of the securities laws Such abuses included the filing of frivolous class action lawsuits, initiated by attorneys with the help of 'professional plaintiffs' with no regard for the culpability of the entity being sued.").

129. Because Rule 9(b) of the Federal Rules of Civil Procedure requires heightened or "particulari[z]ed" pleading in lawsuits alleging "fraud or mistake" and because the PSLRA pleading standard adopted by the Revolution Congress goes significantly beyond any standard anticipated in the Federal Rules, I have adopted the moniker "super heightened" pleading standard to accurately describe what is currently required of securities fraud plaintiffs. "The most striking aspect of the Private Securities Litigation Reform Act of 1995 is its rejection of the system of notice pleading that has governed all civil actions in federal courts since 1938." Weiss & Moser, *supra* note 128, at 457.

130. See BABCOCK & MASSARO, *supra* note 128, at 316-24.

131. See Avery, *supra* note 127, at 335-37.

132. See *Private Litigation Under the Federal Securities Laws: Hearings Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing, and Urban Affairs*, 103d Cong. 104-05 (1993) [hereinafter *Hearings*] (statement of John G. Adler, President, Adaptec, Inc.); see also Wong, *supra* note 128, at 835. Wong argues that:

Plaintiffs' lawyers would routinely engage in a "race to the courthouse" in order to file their complaint first and consequently be named lead counsel in a securities class action. Despite the fact that most of these suits were meritless, the defendant corporations usually chose to settle the cases rather than face the enormous expenses of discovery and trial. The plaintiffs' lawyers often negotiated such settlements to favor themselves rather than the investors they purported to represent.

Id. (citations omitted); see also *supra* note 128 and accompanying text. But see Joel Seligman, *The Merits Do Matter*, 108 HARV. L. REV. 438, 439 (1994). Professor Seligman, in 1994, took issue with those corporate voices clamoring for relief from securities fraud lawsuits:

suits were severely impairing the ability of corporate America to conduct its business in an unfettered, capitalistic way.¹³³ Congress, buying into these corporate management pleas, voted to add the “super heightened” pleading standard to securities fraud class-action suits, while removing a variety of investor protections from the 1933 Securities Act and the 1934 Securities Exchange Act.¹³⁴

1. *The “Super Heightened” Pleading Standard*

Perhaps the most onerous PSLRA revision to the federal securities laws was the amendment that departed from the Federal Rules of Civil Procedure and inflated the pleading standard for class-action securities plaintiffs to an often times unattainable level.¹³⁵ The new

The proponents of new restrictions have argued: “Securities litigation has gotten out of hand and is destroying the very capital formation policy it seeks to promote.” For example, one businessman has argued that “companies can become more reluctant to take business risks, for each time a business fails, [it is] subject to a suit for fraud.”

For all the emotional appeal of arguments that excessive litigation is destroying capital formation, existing data illustrate a quite different picture.

Id. at 439–40; *see also* Lerach, *supra* note 13, at 76–77 (“The tsunami of special-interest money was flavored by anecdotal tales of woe from Big Six accounting-firm partners and high-tech corporate executives who whined to congress about how class action suits by avaricious lawyers distracted them from running their enterprises, resulted in ‘blackmail’ settlement that injured public companies, diminished productive activities, made it difficult to obtain outside corporate directors, threatened partners in professional firms with ruin and undermined job and economic growth.”); Lynn A. Stout, *Type I Error, Type II Error, and the Private Securities Litigation Reform Act*, 38 ARIZ. L. REV. 711, 713–15 (1996) (countering the argument that strike suits cripple corporate America and capital formation by estimating that the value of corporate fraudulent schemes not litigated cost hundreds of billions of dollars per year in market valuation, while the value of strike suits involve one-tenth the cost of fraudulent misbehavior).

133. *See Hearings, supra* note 132, at 76–77.

134. In identifying abuses in class-action litigation against publicly-held corporations, the House and Senate committees designated the following abuses as representative:

(1) the routine filing of lawsuits against issuers of securities and others whenever there is a significant change in an issuer’s stock price, without regard to any underlying culpability of the issuer, and with only faint hope that the discovery process might lead eventually to some plausible cause of action; (2) the targeting of deep pocket defendants, including accountants, underwriters, and individuals who may be covered by insurance, without regard to their actual culpability; (3) the abuse of the discovery process to impose costs so burdensome that it is often economical for the victimized party to settle; and (4) the manipulation by class action lawyers of the clients whom they purportedly represent.

RATNER & HAZEN, *supra* note 60, at 270. “The 1995 [Private Securities Litigation] Reform Act attempted to deal with these perceived abuses by adopting . . . procedural reforms.” *Id.*

135. *See* 15 U.S.C. § 78u-4(b) (2000). The new super heightened pleading standard provides:

pleading standard for a plaintiff suing a corporation for fraudulent violation of the securities laws requires the victim of the alleged fraud, without any benefit of discovery, to plead particularized facts that will show a "strong inference" that each named defendant acted with a specific intent to defraud.¹³⁶ A plaintiff must "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."¹³⁷ This pleading standard increases the particularity that must be pled to the level of a "strong inference" that each defendant acted with specific intent to defraud, an unusually high burden—in truth, a higher burden than any other federal pleading standard.¹³⁸ If this particularized pleading standard is not met,

(b) Requirements for securities fraud actions.

- (1) Misleading statements and omission. In any private action arising under this title [15 U.S.C. §§ 78a–78u] in which the plaintiff alleges that the defendant—

- a. Made an untrue statement of a material fact; or
- b. Omitted to state a material fact necessary in order to make the statements made, in light of the circumstances in which they were made, not misleading;

the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

- (2) Required state of mind. In any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission alleged to violate this title, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind

Id.; see also Steven A. Ramirez, *Arbitration and Reform in Private Securities Litigation: Dealing with the Meritorious as well as the Frivolous*, 40 WM. & MARY L. REV. 1055, 1059–60 (1999). "Perhaps the most critical effect of the PSLRA, however, is that it leaves private enforcement of the federal securities laws in near terminal condition." *Id.*; see also Perino, *supra* note 121, at 925 (describing what the PSLRA pleading standard requires of securities plaintiffs). Professor Perino writes that:

The pleading standard consists of three components. First, the Act contains a specificity requirement with respect to allegations that a statement of omission is false or misleading. The complaint is required to specify which statements are misleading and the reasons why the statements are misleading. Second, when a complaint is pleaded on information and belief, the plaintiff must state "with particularity all facts on which that belief is formed." Third, plaintiffs are required to "state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind."

Id. (footnotes omitted).

136. See *id.*

137. BABCOCK & MASSARO, *supra* note 128, at 321.

138. See *id.*; see also Lerach, *supra* note 13, at 77 ("These restrictions on shareholder suits under federal law were uniquely punitive. No such set of rules disadvantag-

the class action is not certified and the victims of the alleged fraud are foreclosed from proceeding in their lawsuit.¹³⁹

Further hampering victims of alleged securities fraud is the PSLRA amendment that mandates, absent certain findings by the court, an automatic stay of discovery in any securities lawsuit while the (routine) motion to dismiss is pending before the court.¹⁴⁰ Additionally, the amendment requires plaintiffs both to identify specific statements made by the accused management that were in fact misleading and to also explain how and in what way the fraudulent statements were misleading.¹⁴¹

Pre-PSLRA, a victim of securities fraud was required to satisfy Rule 9(b) of the Federal Rules of Civil Procedure that mandates a heightened, particularized pleading standard as to fraud but required only a reasonable belief in the original pleading that each named defendant acted with a specific intent to defraud.¹⁴² Thus, prior to passage of the PSLRA, fraud had to be pled “with particularity,” but intent could be “averred generally.”¹⁴³ Thereafter, a plaintiff class was able to conduct discovery as the lawsuit proceeded, prior to a motion to dismiss hearing, in order to uncover further fraud and misrepresentation.¹⁴⁴ Congress, in adopting the “super heightened” pleading standard, for all intents and purposes removed any ability to discover fraud or malfeasance except within the original pleadings. Thus, after

ing plaintiffs exists in any other field of civil litigation under federal law.”) (emphasis removed).

139. See H.R. 1058, 104th Cong. § 101(a) (1995) (§ 21D(b)(3)(A) of the Securities Exchange Act); see also Lerach, *supra* note 13, at 87. Lerach reports:

[S]ince the 1995 [Public Securities Litigation Reform] Act [the Ninth Circuit Court of Appeals] has thrown 18 consecutive securities fraud suits by investors out of court. Eighteen times in a row, using the 1995 Act, the Ninth Circuit has sided with corporate interests and closed the courthouse door to defrauded investors. Not one complaint out of 18 upheld or permitted to go forward!

Id. (emphasis removed); see also *infra* section II.D.

140. See 15 U.S.C. § 78u-4(b)(3). This provision requires:

(B) Stay of Discovery. In any private action arising under this title, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

Id.

141. See *supra* notes 129–30, 136–37.

142. See *In re Glenfed, Inc. Sec. Litig.*, 42 F.3d 1541 (9th Cir. 1994).

143. See FED. R. CRV. P. 9(b) (“Fraud, Mistake, Condition of the Mind. In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge and other condition of mind of a person may be averred generally.”); see also BABCOCK & MASSARO, *supra* note 128, at 317.

144. See Lewis D. Lowenfels & Alan R. Bromberg, *A New Standard for Aiders and Abettors Under the Private Securities Litigation Reform Act of 1995*, 52 BUS. LAW 1, 4 (1996); see also Avery, *supra* note 127, at 335.

raising the standard for the original pleading, Congress attempted to bar many of the available successful avenues of class-action securities fraud relief.¹⁴⁵

Prior to passage of the PSLRA, the debate about the heightened pleading standard for securities fraud actions intensified through a split in the U.S. Court of Appeals, where the Second Circuit adopted a very strict particularized pleading requirement and the Ninth Circuit adopted a significantly less strenuous pleading standard for securities fraud class actions.¹⁴⁶ Essentially, both Circuits identified the need for securities fraud pleadings to meet the heightened pleading standard required by Rule 9(b) of the Federal Rules. However, the Second Circuit directed plaintiffs appearing before the federal courts in that Circuit to plead intent and knowledge with very specific allegations:

It is reasonable to require that the plaintiffs specifically plead those events which they assert give rise to a strong inference that the defendants had knowledge of the facts contained in . . . the complaint or recklessly disregarded their existence. And, of course, plaintiffs must fix the time when these particular events occurred.¹⁴⁷

Thus, pre-PSLRA, the Second Circuit mandated that securities fraud claimants plead facts giving rise to a strong inference of fraudulent intent.¹⁴⁸

145. See *supra* notes 135–41 and accompanying text; see also President's Message to the House of Representatives Returning Without Approval the Private Securities Litigation Reform Act, *supra* note 124, at 2. President Clinton, in his PSLRA veto statement, discussing the heightened pleading standard, stated:

The conferees deleted an amendment offered by Senator Specter and adopted by the Senate that specifically incorporated Second Circuit case law with respect to pleading a claim of fraud. Then they specifically indicated that they were not adopting the Second Circuit case law but instead intended to "strengthen" the existing pleading requirements of the Second Circuit. All this shows that the conferees meant to erect a higher barrier to bringing suit than any now existing—one so high that even the most aggrieved investors with the most painful losses may get tossed out of court before they have a chance to prove their case.

Id. at 1–2 (emphasis added).

146. Compare *Ross v. A.H. Robins Co.*, 607 F.2d 545 (2d Cir. 1976), *cert. denied*, 446 U.S. 946 (1980), with *In re Glenfed, Inc. Sec. Litig.*, 42 F.3d 1541 (9th Cir. 1994) (en banc).

147. *A.H. Robins Co.*, 607 F.2d at 558.

148. Of course, requiring parties to plead fraudulent *intent* with specificity, prior to discovery, is a daunting, nearly impossible task that is not required by the Federal Rules of Civil Procedure. The Second Circuit wrote this requirement into its securities fraud jurisprudence and was criticized for its activism in so doing. See *In re Glenfed, Inc. Sec. Litig.*, 42 F.3d at 1546. The Ninth Circuit criticized the Second Circuit thusly:

The Second Circuit's test may or may not have the effect of deterring or weeding out "strike suits," which various courts have seen as imposing undesirable social and economic costs. . . . Whether the test has such an effect is beside the point. We are not permitted to add new requirements to Rule 9(b) simply because we like the effect of doing so. This is a job for

In contrast, the Ninth Circuit held firmly that intent (scienter) could be averred generally in a securities fraud lawsuit, but that under Rule 9(b), fraud alone must be pled with specificity:

To allege fraud with particularity, a plaintiff must set forth more than the neutral facts necessary to identify the transaction. The plaintiff must set forth what is false or misleading about a statement, and why it is false. In other words, the plaintiff must set forth an explanation as to why the statement or omission complained of was false or misleading. A plaintiff might do less and still identify the statements complained of¹⁴⁹

Motivated by the split in the Court of Appeals, the 104th Congress, rather than wait for Supreme Court interpretation of what was required under Rule 9(b), leaped at the opportunity to severely restrict securities fraud actions by adopting an unprecedented “special pleading” requirement, completely independent of the Federal Rules of Civil Procedure and the requirements of Rule 9(b)—the “super heightened” pleading standard for securities fraud plaintiffs.¹⁵⁰

While some argue that the PSLRA adopted, in essence, the Second Circuit’s securities fraud pleading formulation,¹⁵¹ the reality is that the pleading standard created under the PSLRA is even more stringent than that promulgated by the Second Circuit.¹⁵² At the brink of PSLRA adoption in 1995 and adoption of the “super heightened” pleading standard, Senator Paul Sarbanes, (D-Maryland), reminded the U.S. Senate that the Second Circuit standard, which the Revolution Congress sought to codify, was the harshest pleading standard adopted by any U.S. Court of Appeals and was the decidedly minority view amongst the U.S. circuit courts.¹⁵³ Notwithstanding, the Revolution Congress adopted the Second Circuit’s pleading standard, but re-

Congress, or for the various legislative, judicial, and advisory bodies involved in the process of amending the Federal Rules.

Id. In adopting the Second Circuit’s “super” heightened pleading standard, and arguably even more, Congress for the first time in history adopted special pleadings that are independent of the Federal Rules of Civil Procedure and Rule 9(b). See *infra* note 152.

149. *In re Glenfed, Inc. Sec. Litig.*, 42 F.3d at 1546.

150. See *supra* notes 129, 148; see also BABCOCK & MASSARO, *supra* note 128, at 323 (“One thing is clear: Special pleading rules now apply to federal private securities litigation that are independent of Fed. R. Civ. P. 9(b). Will this development lead to a proliferation of special pleading rules in other areas? If so, is this a potential revival of the writs?”).

151. See BABCOCK & MASSARO, *supra* note 128, at 321 (“A plaintiff now must ‘state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind,’ essentially adopting the Second Circuit position.”).

152. See *supra* note 124 and accompanying text (regarding President Clinton’s veto statement); see also *infra* notes 265–68 and accompanying text (Senator Sarbanes’ Senate floor speech in opposition to the PSLRA).

153. See 141 CONG. REC. 35,242 (1995) (statement of Senator Sarbanes) (“This standard says investors who seek to file securities fraud cases must ‘specifically allege facts giving rise to a strong inference that the defendant acted with a required

fused to codify the Second Circuit's later clarifying caselaw that enunciated clearer standards for applying the super heightened pleading standard.¹⁵⁴

As predicted, this PSLRA "super heightened" pleading standard has led to much confusion. Because the Revolution Congress failed to adopt Second Circuit clarifying language for securities fraud pleading, the new standard was promulgated in great ambiguity, which has led to "a great deal of litigation in the past few years over precisely what plaintiffs must plead to survive a motion for summary judgment, re-

state of mind.' This standard, it should be noted, is more stringent than the Federal Rules of Civil Procedure and is the minority view among the circuit courts.").

154. This failure to adopt clarifying case law was the basis for arguments that the PSLRA pleading standard initiated an even stricter standard than that imposed by the Second Circuit. See 141 CONG. REC. 35,242 (1995) (statement of Senator Sarbanes). Senator Sarbanes carefully explained how the PSLRA standard eclipsed the Second Circuit pleading standard in severity:

When the bill came to the Senate floor, the Senate adopted an amendment to this provision offered by the distinguished Senator from Pennsylvania, Senator Specter. *Senator Specter's amendment codified into the legislation additional second circuit holdings clarifying the standard they had earlier enunciated. These additional holdings state that a plaintiff may meet the pleading standard by alleging facts showing the defendant had motive and opportunity to commit fraud, or constituting strong circumstantial evidence of state of mind.* In other words, the second circuit laid down this standard and then had subsequent opinions that elaborated upon it and developed it, and Senator Specter said that if you are going to include the second circuit standard as initially enunciated, you should also include the further holdings by the second circuit clarifying this standard.

This, I think, was the one pro-investor amendment adopted on the Senate floor. What happened to this amendment in conference? It disappeared. It was dropped from the legislation. This is part of this process that I have been outlining here of now you see it, now you don't. Of course, the person who bears the brunt of that is the investor.

The draft conference report deleted the Specter amendment, leaving investors without the protection of the additional second circuit holdings. Once again, a pro-investor provision that would have provided some balance to the bill was removed.

Id. (emphasis added); see also President's Message to the House of Representatives Returning Without Approval the Private Securities Litigation Reform Act, *supra* note 124. President Clinton stated very specifically in his PSLRA veto message that:

The conferees deleted an amendment offered by Senator Specter and adopted by the Senate that specifically incorporated Second Circuit case law with respect to pleading a claim of fraud. *Then they specifically indicated that they were not adopting Second Circuit case law but instead intended to "strengthen" the existing pleading requirements of the Second Circuit.* All this shows that the conferees meant to erect a higher barrier to bringing suit than any now existing—one so high that even the most aggrieved investors with the most painful losses may get tossed out of court before they have a chance to prove their case.

Id. (emphasis added).

sulting in a wide variety of court interpretations."¹⁵⁵ Once again, the U.S. Courts of Appeals have adopted various and wide-ranging interpretations of what exactly is required under the "super heightened" pleading standard.¹⁵⁶ One commentator claims that an emerging consensus seems to be that allegations of a generalized desire by corporate executives to raise capital or increase their compensation is not a specific enough particularized pleading to meet the new standard, while showing corporate executives' material departures from generally accepted accounting standards will typically be a specific enough pleading.¹⁵⁷ Notwithstanding, in light of the corporate corruption that engulfed the U.S. capital markets in 2001 and 2002, the adoption of the "super heightened" pleading standard now must be critically examined. To that end, much evidence is available that the adoption of a "super heightened" pleading standard was wholly unnecessary,¹⁵⁸ and has led to rarely-before-encountered corporate fraud.¹⁵⁹

2. *Super Heightened Pleading Standard Unnecessary*

Rule 9(b) of the Federal Rules of Civil Procedure requires a heightened pleading standard under two specific situations identified by Congress as necessary: instances of fraud or mistake.¹⁶⁰ Prior to passage of the PSLRA, Rule 9(b) required all securities fraud allegations

155. BABCOCK & MASSARO, *supra* note 128, at 322; see also Elliott J. Weiss, *The New Securities Fraud Pleading Requirement: Speed Bump or Road Block?*, 38 ARIZ. L. REV. 675, 677 (1996) ("The problem with which courts have been grappling—and the problem that [PSLRA] section 21D(b)(2) addresses—is how much more to require of a plaintiff before allowing her to litigate a claim of open market fraud."); R. Tyler Hand, Note, *The Private Securities Litigation Reform Act of 1995: Heightened Pleading Standards in Class Action Litigation*, 26 AM. J. TRIAL ADVOC. 685, 685–86 (2003) ("At the close of 2002, circuits have adopted three different interpretations of the Reform Act's heightened [pleading] standards. Until the United States Supreme Court interprets the Reform Act's provisions, it is likely that a split among the circuits will persist."); Charles F. Hart, Note, *Interpreting the Heightened Pleading of the Scienter Requirement in Private Securities Fraud Litigation: The Tenth Circuit Takes the Middle Ground*, 80 DENV. U. L. REV. 577, 604 (2003) (examining the Tenth Circuit's adoption of the PSLRA pleading standard "middle ground" highlighting the confused circuit split in interpreting what must be pled to survive a motion to dismiss post-PSLRA).

156. See BABCOCK & MASSARO, *supra* note 128, at 322.

157. See Steven B. Rosenfeld, *Pleading Scienter Under the Private Securities Litigation Reform Act of 1995*, 1085 PLI/CORP. 791 (1998).

158. See Seligman, *supra* note 132, at 457. Directly prior to PSLRA enactment, Professor Seligman argued that "[w]hat has been most lacking in the legislative debate to date has been authentic data that provides empirical or theoretical support for particularized law revision. If there is a case for significant changes in the federal securities class action law, it simply has not been presented to date." *Id.*

159. See *supra* subsection II.A.2.

160. See FED. R. CIV. P. 9(b).

to be pled with particularity.¹⁶¹ Already, securities fraud cases required a heightened pleading. Still, the requirement to plead facts with particularity as required by Rule 9(b) was not enough to satisfy the Revolution Congress.¹⁶² As the Republican Revolutionaries took their seats in the 104th Congress, they immediately invited corporate executives and corporate lobbyists into their congressional offices to begin drafting legislation that would deregulate U.S. corporate law and, in the long run, would end up protecting corporate malfeasance.¹⁶³ This unprecedented nod to special interests simply was not necessary to defray securities fraud strike suits.

The pleading requirements and restrictions established by the Federal Rules of Civil Procedure were appropriately winnowing frivolous lawsuits prior to enactment of the PSLRA. Rule 9(b), Rule 12(b)(6), and Rule 11¹⁶⁴ were giving corporate defendants more than sufficient protection against frivolous claims, as such claims under the Federal Rules were being dealt with seriously and strenuously.¹⁶⁵ Leading academics in the securities regulation field argued persuasively in the early 1990s, prior to passage of the PSLRA, that frivolous strike suits were being dismissed at significant rates, based either on failures to meet the Rule 9(b) heightened pleading standard or on a Rule 12(b)(6) motion to dismiss for failure to state a claim upon which

161. See BABCOCK & MASSARO, *supra* note 128, at 316–17.

162. See *id.* at 321–22.

163. See Cook, *supra* note 10, at 44. Cook describes the environment permeating the 104th Congress as the Contract with America took shape:

Even before the new Congress convened, Representative Tom DeLay, the Republican majority whip, was assembling a coalition called “Project Relief.” The Project brought together more than 100 groups (and their lobbyists) behind a very narrow cause: stopping federal regulations of business.

The honor of serving on Project Relief—and helping to draft the legislation—did not come cheaply, according to a painstaking study of Federal Election Commission (FEC) records by the Washington, D.C.-based Environmental Working Group. In just two years (1993–1994), the 115 PACs now associated with Project Relief gave members of the House \$10.3 million. DeLay alone received \$38,000. Indiana Republican David McIntosh, the chairman of the House Regulatory Affairs Subcommittee, received \$37,000 from Project Relief PACs.

Even before DeLay had finished moving into his new office, the collection of powerful business and industry lobbyists convened, according to a March article in *The Washington Post*.

Id.; see also *supra* note 10 (detailing DeLay’s formal admonishment from the House of Representatives Ethics Committee for unseemly solicitous activity).

164. See FED. R. CIV. P. 9(b), 11, 12(b)(6).

165. See Janet Cooper Alexander, *Do Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STAN. L. REV. 497, 526 (1991); see also Seligman, *supra* note 132, at 442 (“In contrast to data supporting the health of capital formation and testimony on the importance of the private rights of action, there appear to be only undocumented assertions that litigation in some way has impeded capital formation.”).

relief might be granted.¹⁶⁶ In 1992, the Securities Industry Association reported that forty-six motions to dismiss for failure to meet the pleading standard required by Rule 9(b) were filed, and of those forty-six motions, twenty-nine were granted—a sixty-three percent dismissal rate.¹⁶⁷

Further, data that was available to the Senate Securities Subcommittee in the early 1990s suggested that the corporate executives charging that strike suits were crippling corporate America were significantly overstating the problem.¹⁶⁸ The leading securities plaintiff litigation law firm reported that in 1990 and 1991, 111 securities fraud lawsuits were filed, with forty-three being dismissed on motion—a thirty-eight percent dismissal rate.¹⁶⁹ These lawsuits were being dismissed at the pleading stage, before significant time or expense had been incurred by the defendant corporation in legal or discovery costs.

Despite the success many corporations were having in knocking down securities fraud claims at the pleading stage, the Revolution Congress still felt that corporate interests were not being protected enough.¹⁷⁰ Now, in light of the market collapse of 2002 and the unbelievable trail of corporate fraud, even strong supporters of the Republican Revolution and the Contract with America are admitting that the PSLRA simply went too far.¹⁷¹

166. See Alexander, *supra* note 165, at 526; see also Seligman, *supra* note 132, at 445–46.

167. See Seligman, *supra* note 132, at 446 (“One may reasonably infer from such data that courts have at least some success in winnowing out nonmeritorious lawsuits.”).

168. See *id.* at 445.

169. See *id.* at 446; see also Joel Seligman, *Rethinking Private Securities Litigation*, 73 U. CIN. L. REV. 95, 96 (2004) (“Despite all the emotional appeal of arguments that excessive litigation was destroying capital formation, the data available at the time suggested a quite different picture.”).

170. See Perino, *supra* note 121, at 913. Professor Perino carefully examines whether the PSLRA achieved its primary goals, which were (1) discouraging the filing of nonmeritorious “strike” suits; (2) reducing litigation risk for high technology issuers; and (3) reducing the “race to the courthouse” wherein class-action securities lawsuits were “filed soon after significant stock price declines” with little prefiling investigation. *Id.*; see also Seligman, *supra* note 169, at 109. Dean Seligman, reacting to these stated PSLRA goals, observed:

Proponents of a new law are expected to be emphatic in championing the law’s virtues, but [congressional] assertions such as “the routine filing of lawsuits against issuers . . . whenever there is a change in an issuer’s stock price, without regard to any underlying culpability of the issuer” were shocking for their distortion of the available evidence. The [PSLRA] appeared to be less a response to a litigation crisis than a response to a dramatically changed political landscape.

Id. (omission in original); *supra* note 134.

171. See *Profile: Recent Wall Street Scandals Lead to Crackdown on Alleged Corporate Corruption* (NPR radio broadcast, Jan. 19, 2004) (on file with author and availa-

B. How the PSLRA Amended the Federal Securities Laws

One significant PSLRA revision to the federal securities laws was the amendment that created a safe-harbor provision for forward-looking statements, which, in effect, served (and still serves) to shield issuers and management from private liability in connection with false or misleading forward-looking statements.¹⁷² If an issuer accompanies its false or misrepresentative information with “meaningful cautionary statements,” then it will escape private liability under the revised securities laws.¹⁷³ Thus, if accompanied by meaningful cautionary language, intentional misrepresentation and false financial projections are excused and liability is removed under the PSLRA.¹⁷⁴

Under the safe harbor, forward-looking statements, even if false, are not actionable if they are identified as forward-looking statements and are “accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement.” Even if the statement is not properly identified or is not accompanied by the appropriate cautionary language, it still falls within the safe harbor if it is immaterial or if the plaintiff fails to prove that the defen-

ble in the Schmid Law Library at the University of Nebraska College of Law) (detailing recent comments from members of conservative Washington, D.C. thinktanks admitting that the PSLRA had gone too far).

172. See 15 U.S.C. § 78u-5(c) (2000).

173. See *id.* The new safe harbor provides:

(c) Safe harbor.

(1) In general. Except as provided in subsection (b), in any private action arising under this title that is based on an untrue statement of a material fact or omission of a material fact necessary to make the statement not misleading, a person referred to in subsection (a) shall not be liable with respect to any forward-looking statement, whether written or oral, if and to the extent that—

(A) the forward-looking statement is—

(i) identified as a forward-looking statement, and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement; or

(ii) immaterial; or

(B) the plaintiff fails to prove that the forward-looking statement—

(i) if made by a natural person, was made with actual knowledge by that person that the statement was false or misleading; or

(ii) if made by a business entity; was—

(I) made by or with the approval of an executive officer of that entity; and

(II) made or approved by such officer with actual knowledge by that officer that the statement was false or misleading. . . .”

Id. (footnote omitted).

174. See *id.*; see also Perino, *supra* note 121, at 927.

dant had “actual knowledge” that the forward-looking statement was false or misleading.¹⁷⁵

Certainly, eradicating liability for intentional false projections cannot square with the intent of the drafters of the federal securities laws in the 1930s, where the primary objective was to protect investors and ensure that honest, straightforward information was widely disseminated.¹⁷⁶

Unquestionably, forward-looking projections are by definition conjectural, and safeguards must be in place if corporations are to be induced to make future assessments.¹⁷⁷ Providing a safe harbor from private liability for all forward-looking statements, even those that are intentionally misleading, goes too far.¹⁷⁸

175. Perino, *supra* note 121, at 927 (quoting language enunciated in various provisions of the PSLRA).

176. *See supra* notes 57–61, 67–71 and accompanying text.

177. *See* JOHN C. COFFEE, JR. & JOEL SELIGMAN, SECURITIES REGULATION 1008–09 (9th ed. 2003). Professors Coffee and Seligman describe the genesis of “forward looking statements” in required disclosure documents as follows:

More than the case decisions, the most significant driving force for mandatory disclosure of forward looking statements was the SEC. Item 303(a) of Regulation S-K effectively requires management to disclose certain estimates and projections in its Management’s Discussion and Analysis of Financial Condition and Results of Operations (the “MD & A”), which is a required item in both the Annual Report on Form 10-K and the Quarterly Report on Form 10-Q. Specifically, the MD & A must contain a description of “known trends . . . demands, commitments, events or uncertainties that will result in or that are reasonably likely to result in the registrant’s liquidity increasing or decreasing in any material way.” Similar disclosure is required of “any known trends or uncertainties that have had or that the registrant reasonably expects will have a material favorable or unfavorable impact on net sales or income from continuing operations.”

Id. at 1008 (citations omitted). Further, the SEC has drawn a careful distinction between required prospective information and voluntary forward-looking disclosure:

“Both required disclosure regarding the future impact of presently known trends, events or uncertainties and optional forward-looking information may involve some prediction or projection. The distinction between the two rests with the nature of the prediction required. Required disclosure is based on currently known trends, events and uncertainties that are reasonably expected to have material effects, such as a reduction in the registrant’s product prices; erosion in the registrant’s market share; changes in insurance coverage; or the likely non-renewal of a material contract. In contrast, optional forward-looking disclosure involves anticipating a future trend or event or anticipating a less predictable impact of a known event, trend or uncertainty.”

Id. at 1009 (quoting Exchange Act Release No. 6711, 38 S.E.C. Docket 138, 140–41 (1987)); *see generally id.* at 1020–21 (discussing generally the “bespeaks caution” doctrine and the codification of that doctrine in the PSLRA).

178. *See* HAZEN & RATNER, *supra* note 67, at 256. In describing the impetus behind the enactment of the “safe harbor” protecting forward-looking statements, Hazen and Ratner describe:

Another PSLRA revision to the federal securities laws was the amendment that requires courts in a private securities fraud action to set forth specific findings detailing whether plaintiffs' counsel complied with Rule 11(b)¹⁷⁹ of the Federal Rules of Civil Procedure.¹⁸⁰ This provision places an automatic Rule 11 burden on federal judges and simultaneously threatens securities fraud class-action plaintiffs' attorneys with personal liability if the allegations in the complaint lack adequate factual support.¹⁸¹ This Rule 11 provision of the

The Private Securities Litigation Reform Act of 1995, enacted for the purpose of restricting class actions against publicly-held corporations on the basis of allegedly inaccurate projections . . . codifies the "bespeaks caution" doctrine by providing that a company cannot be held liable for a "forward looking statement [that] is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward looking statement."

Id. (quoting 15 U.S.C. § 78u-5(c)(1)).

179. See FED. R. CIV. P. 11(b). Regarding the truthfulness-in-pleading requirements of Rule 11, Dean Mary Kay Kane notes:

The two most common methods used to promote truthfulness in pleading and discourage the filing of frivolous claims and defenses are an attorney signature requirement and verification. In many jurisdictions, the attorney is required to sign the pleadings and that signature stands as a certification that the claim or defense is filed in good faith—that there are good grounds to support it and that it is not interposed for purposes of delay. . . .

. . . [T]he federal rules were amended in 1983 to provide that the attorney signature is to be affixed only after "a reasonable inquiry" as to whether there are sufficient grounds in law and in fact to support the pleadings. Fed. Rule 11. Sanctions for noncompliance were made mandatory. These changes were designed to allow the court to apply objective criteria as to the attorneys' reasonable inquiry and to enlarge the use of the sanction power so as to deter marginal conduct. Considerable litigation involving Rule 11 occurred after its amendment and questions were raised concerning very basic features of the revised requirement, as well as whether the amended rule was achieving its purpose or was breeding a new form of satellite litigation. Thus, there was substantial pressure to revise the rule and 1993 amendments were made to try to respond to some of the criticism.

The revised rule continues to utilize an objective, rather than subjective, bad-faith standard for assessing whether the signer made a reasonable inquiry and concluded that the pleading was well-grounded in fact and law. . . . Sanctions for violations are now discretionary, however, and a "safe harbor" provision is included by which parties desiring to request sanctions must wait at least 21 days after the paper has been filed and, if the alleged violation is cured in that period, no sanction motion can be filed. Fed. Rule 11(c)(1)(A).

MARY KAY KANE, CIVIL PROCEDURE: IN A NUTSHELL 100–01 (5th ed. 2003).

180. See 15 U.S.C. § 78u-4(c)(1) (2000). This PSLRA provision provides:

(1) Mandatory review by court. In any private action arising under this title, upon final adjudication of the action, the court shall include in the record specific findings regarding compliance by each party and each attorney representing any party with each requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion.

181. See *id.*; see also Lerach, *supra* note 13, at 77.

PSLRA was intended to act as a profound disincentive to plaintiffs’ lawyers for bringing securities fraud class-action lawsuits. Requiring a federal court to always set forth specific findings as to whether an attorney met his or her Rule 11 burden is an unprecedented requirement,¹⁸² meant to discourage victims of securities fraud from hiring attorneys,¹⁸³ and to dissuade securities fraud attorneys from monitoring the securities markets for apparent fraudulent behavior on the part of U.S. businesses and soliciting clients for the purpose of bringing suit against malfeasant corporations.¹⁸⁴

Pre-PSLRA, the Rule 11 criterion for securities fraud lawsuits was the same as in all other federal actions.¹⁸⁵ Opposing parties ordinarily brought a Rule 11 motion for sanctions, and a federal judge, after waiting twenty-one days to determine whether the alleged violation was cured, then determined whether sanctions were warranted in his or her discretion.¹⁸⁶ Now, under the PSLRA, a judge must set forth Rule 11 findings and is forced to impose sanctions if a single allegation lacks adequate factual support.¹⁸⁷

182. See generally KANE, *supra* note 179, at 100–02 (describing the policy behind Rule 11 of the Federal Rules of Civil Procedure and detailing the normal process of requesting Rule 11 sanctions).

183. See 141 CONG. REC. 35,242 (1995) (statement of Senator Sarbanes). In referring to the PSLRA the evening of its enactment, Senator Sarbanes guessed that the purpose of the Act was not just to end frivolous securities fraud lawsuits, but to end almost all securities fraud lawsuits:

Disparate treatment. The bill, as sent out of the Senate, had balanced treatment with respect to plaintiffs and defendants. Now [after the bill had returned from conference] we have this disparate treatment, and there is not justification for it. *Its true purpose, I think, is to scare investors from bringing meritorious fraud suits.* When the conference removed the balance from this provision, it was not deterring frivolous lawsuits, it was hurting investors.

Id. (emphasis added).

184. See generally Lerach, *supra* note 13, at 94 (noting prior to PSLRA enactment that if these disincentive provisions were enacted, then securities fraud plaintiffs’ lawyers, like himself, would be unable to bring private victim lawsuits). Lerach, testifying before Congress, prior to passage of the PSLRA, avowed:

If the antifraud provisions of the securities laws are gutted [as proposed in the PSLRA] . . . don’t worry about me, I will go make a living somewhere else. *Worry about the public and your markets, and in ten or fifteen years you will be holding another hearing with the debacle in the securities markets that will make you remember the S&L mess with fondness.* Because the fraudsters and the dishonest [corporate executives] are there, and if the prohibitions against fraud are removed, they will come forward and they will become more active

Id. (emphasis added).

185. See generally KANE, *supra* note 179, at 100–02 (describing the policy behind Rule 11 of the Federal Rules of Civil Procedure and detailing the normal process of requesting Rule 11 sanctions).

186. See generally *id.*

187. See 15 U.S.C. § 78u-4(c)(2) (2000). This section of the PSLRA provides:

Once again, the 104th Congress enacted a provision changing the requirements of the Federal Rules of Civil Procedure in an unprecedented way, and again, only in the securities fraud lawsuit arena. The 1993 amendments to Rule 11 and the Federal Rules of Civil Procedure were based almost entirely upon the notion that federal district court judges were to be granted broad discretion in determining whether and when to impose Rule 11 sanctions.¹⁸⁸ Two short years later, the Revolution Congress removed its grant of broad discretion under Rule 11 and imposed a mandatory, discretionless obligation upon federal district court judges to sanction pleading-weak parties in securities fraud cases.¹⁸⁹

A further PSLRA amendment to the federal securities laws severely limits damages available to successful securities fraud plaintiffs by establishing a damage award arrived at by comparing the market price of the security to the difference between the purchase or sale price of the security and the mean trading price of that security during a ninety-day period beginning on the date on which the fraudulent activity was disclosed.¹⁹⁰ This places serious limitations on the damages a defrauded investor can recover; this only after a plaintiff successfully navigates the minefield laid down by other PSLRA provisions.¹⁹¹

In enacting the PSLRA, the Revolution Congress attempted to bolt the doors to federal relief for class-action securities fraud plaintiffs,¹⁹²

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- (2) Mandatory sanctions. If the court makes a finding under paragraph (1) that a party or attorney violated any requirement of Rule 11(b) of the Federal Rules of Civil Procedure as to any complaint, responsive pleading, or dispositive motion, the court shall impose sanctions on such party or attorney in accordance with Rule 11 of the Federal Rules of Civil Procedure. Prior to making a finding that any party or attorney has violated Rule 11 of the Federal Rules of Civil Procedure, the court shall give such party or attorney notice and an opportunity to respond.

Id.

188. See BABCOCK & MASSARO, *supra* note 128, at 384-87.

189. See 15 U.S.C. § 78u-4(c)(2).

190. See *id.* This provision states:

- (1) In general. Except as provided in paragraph (2), in any private action arising under this title in which the plaintiff seeks to establish damages by reference to the market price of a security, the award of damages to the plaintiff shall not exceed the difference between the purchase or sale price paid or received, as appropriate, by the plaintiff for the subject security and the mean trading price of that security during the 90-day period beginning on the date on which the information correcting the misstatement or omission that is the basis for the action is disseminated to the market.

Id.

191. See *supra* note 139 (describing the attempted lock-down of available federal court relief for victims of securities fraud after the passage of the PSLRA); see also *infra* note 233 and accompanying text.

192. See *supra* note 134; see also *infra* note 233 and accompanying text.

to deter lawyers from bringing securities fraud cases,¹⁹³ and to dispirit victims of securities fraud from finding an attorney and bringing a fraud lawsuit.¹⁹⁴ But even after an attorney, a victim, and/or a class has surpassed each impediment imposed by the PSLRA, and been deemed a victor in a lawsuit, any recovery is severely constricted for the victims of corporate fraud.¹⁹⁵ Some argue that the Revolution Congress attempted to effectively “reform” successful private securities class actions out of existence.¹⁹⁶

In 1994, the U.S. Supreme Court contributed to the 104th Congress’s deregulation and reform fray by boosting the plaintiff’s proof requirement in a claim for aiding and abetting in violation of the federal securities laws.¹⁹⁷ Now, in order to prevail in a private right of action alleging aiding and abetting liability, the plaintiff must prove that the harm done by the aider and abettor was the “proximate cause” of a defendant’s fraudulent activity.¹⁹⁸ Further, a court can reduce or deny recovery if the harm was caused by mere market depreciation.¹⁹⁹ Prior to *Central Bank of Denver, N.A. v. First Interstate*

193. See *supra* notes 179–84 and accompanying text.

194. See *supra* notes 182–84 and accompanying text.

195. See *supra* notes 190–91 and accompanying text.

196. See Lerach, *supra* note 13, at 87; see also *supra* note 139. But see Wong, *supra* note 128, at 833–34 (detailing the increase of securities fraud class actions in recent years); see also Perino, *supra* note 121, at 915 (detailing a voluminous case study indicating that more securities class-action lawsuits have been filed annually after passage of the PSLRA):

To explore whether the Reform Act achieved [its] goals, this article uses a database of 1,449 securities fraud class actions filed in federal court from 1996 to 2001, the first six years after passage of the PSLRA.

The picture that emerges from studying these data is complicated. It seems clear, however, that the PSLRA did not work as its backers intended. The best available evidence suggests that there are as many, if not more, class actions filed annually after passage of the PSLRA as before.

Id. (footnote omitted). While recognizing that the number of lawsuits filed post-PSLRA has increased, Perino acknowledges that no quantifiable data yet reveals the reason behind the increase in filings:

To date . . . the evidence suggests that securities class actions are at least as frequent following passage of the PSLRA as they were before if not more frequent. Whether this apparent increase is due to an increased level of fraud, an increase in filings in response to the increase in risk plaintiffs’ attorneys face, or both remains unanswered.

Id. at 941–42. A fairly obvious logical conclusion would be that in light of the corporate malfeasance that plagued the markets in the late 1990s and the disintegration of the “dot-com” boom in Silicon Valley at the same time, an increase in securities class-action lawsuits filed is simply a byproduct of the astonishing fraud perpetrated by corporate wrongdoers following PSLRA passage.

197. See *Cent. Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164 (1994).

198. See *id.* at 177–79.

199. See Lowenfels & Bromberg, *supra* note 144, at 7.

Bank of Denver, N.A.,²⁰⁰ to prevail on an aiding and abetting claim, a plaintiff was not required to show "proximate cause"; instead, a "but for" showing was enough to prove that an entity aided and abetted a corporate fraud.²⁰¹ This new rule makes it exceedingly more difficult for a victim of securities fraud to hold liable and responsible the other involved parties, including underwriters, accountants, and law firms that assist in the perpetuation of the corporate fraud.²⁰²

Essentially, *Central Bank* removed the private cause of action against secondary actors in securities fraud scenarios. "By the time the Supreme Court issued the *Central Bank* opinion, aiding and abetting liability had been a viable cause of action in the federal courts for twenty-five years."²⁰³ Thus, secondary liability attaching to lawyers, underwriters, or accountants is no longer an available tool for securities class-action plaintiffs. *Central Bank* did however provide that private causes of action could in fact be brought against secondary actors so long as it can be proven that the secondary actors were primary violators in the fraud action.²⁰⁴

To further slant the playing field in favor of corporations and corporate interests, the 104th Congress also enacted a number of supplementary roadblocks to class-action securities fraud plaintiffs. The PSLRA requires plaintiffs who seek to bring a class-action lawsuit to undergo a certification process, whereby potential plaintiffs certify that they are not being paid to bring the lawsuit, that they authorize the filing of the lawsuit, and that they are willing to represent the class.²⁰⁵ The plaintiff also is required to identify any other class actions that have been filed in the past three years wherein she has

200. 511 U.S. 164 (1994).

201. *See id.* at 168–70.

202. *See generally supra* notes 101–05 and accompanying text.

203. Joseph F. Morrissey, *Catching the Culprits: Is Sarbanes–Oxley Enough?*, 2003 COLUM. BUS. L. REV. 800, 816 (2003). "Nevertheless, in 1994 the Supreme Court swooped in and eliminated federal private rights of action under section 10(b) and rule 10b-5 for aiding and abetting securities fraud." *Id.*

204. *Id.* at 820 ("The *Central Bank* Court explained that if all the elements of a primary [10b-5] violation are present then liability should attach to the secondary actor whether that actor is an accountant, a lawyer, a banker or anyone else.").

205. *See* 15 U.S.C. § 78u-4(a)(2)(A) (2000). This "certification" provision provides:

(2) Certification filed with complaint.

(A) In general. Each plaintiff seeking to serve as a representative party on behalf of a class shall provide a sworn certification, which shall be personally signed by such plaintiff and filed with the complaint, that—

(i) states that the plaintiff has reviewed the complaint and authorized its filing;

(ii) states that the plaintiff did not purchase the security that is the subject of the complaint at the direction of plaintiff's counsel or in order to participate in any private action arising under this title;

served as a representative party.²⁰⁶ Also, a plaintiff is prohibited from being a lead plaintiff in more than five securities class actions brought within a three-year period.²⁰⁷ The PSLRA further requires that the federal district court appoint a lead plaintiff in securities fraud class actions by determining who is the most capable of representing the class interests.²⁰⁸ The appointment must take place ninety days after notice is given of the implementation of the action.²⁰⁹ This lead-plaintiff appointment provision of the PSLRA has led to confusion, ambiguity, and controversy in the federal courts.²¹⁰

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- (iii) states that the plaintiff is willing to serve as a representative party on behalf of a class, including providing testimony at deposition and trial, if necessary;
 - (iv) sets forth all of the transactions of the plaintiff in the security that is the subject of the complaint during the class period specified in the complaint;
 - (v) identifies any other action under this title, filed during the 3-year period preceding the date on which the certification is signed by the plaintiff, in which the plaintiff has sought to serve as a representative party on behalf of a class; and
 - (vi) states that the plaintiff will not accept any payment for serving as a representative party on behalf of a class beyond the plaintiff's pro rata share of any recovery, except as ordered or approved by the court in accordance with paragraph (4).

Id.

206. *Id.*

207. *See id.* § 78u-4(a)(3)(B)(vi). This “professional plaintiff” provision requires:

- (vi) Restrictions on professional plaintiffs. Except as the court may otherwise permit, consistent with the purposes of this section, a person may be a lead plaintiff, or an officer, director, or fiduciary of a lead plaintiff, in no more than 5 securities class actions brought as plaintiff class actions pursuant to the Federal Rules of Civil Procedure during any 3-year period.

Id.

208. *See id.* § 78u-4(a)(3)(B)(i). This provision states in pertinent part:

- (i) In general. Not later than 90 days after the date on which a notice is published under subparagraph (A)(i), the court shall consider any motion made by a purported class member in response to the notice, including any motion by a class member who is not individually named as a plaintiff in the complaint or complaints, and shall appoint as lead plaintiff the member or members of the purported plaintiff class that the court determines to be most capable of adequately representing the interests of class members (hereafter in this paragraph referred to as the “most adequate plaintiff”) in accordance with this subparagraph.

Id.

209. *See id.*

210. *See Wong, supra* note 128, at 833–34 (“The PSLRA instructs courts to adopt a presumption that the most adequate party to represent the plaintiff class is the one with the greatest financial interest who also satisfies the Requirement of Federal Rule of Civil Procedure 23. District courts are currently split as to whether or not defendants may challenge the adoption of the lead plaintiff presumption prior to a motion for class certification, and appellate courts seem unwilling to rule on the issue.”) (citations omitted).

Again, the Revolution Congress assigned a completely different set of procedures to securities fraud class actions as compared with the traditional procedural norms for certifying typical class actions.²¹¹

Additionally, a PSLRA amendment eliminated joint and several liability for corporate defendants, allowing plaintiff recovery only if fraudulent defendants knowingly committed a violation of the federal securities laws.²¹² Defendants that have not knowingly committed a

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211. See FED. R. CIV. P. 23; see also KANE, *supra* note 179, at 255–63 (describing the typical procedures followed in federal class actions and the certification process prescribed). Kane explains the general purpose and utility of the class action and the certification process as follows:

The class action device allows one or more persons to sue or be sued on behalf of themselves and other individuals who allegedly possess similar grievances or have been harmed in a similar way. The action is permitted to be brought in a representative fashion in order to allow the assertion of legal rights in situations in which the numbers of people involved and, in some instances, the small individual amounts involved, otherwise effectively would prevent the vindication of those rights. The device also is an efficient and economical means for the courts and the parties to try a case in which there are common interests, rather than having to resort to multiple, duplicative lawsuits. Thus, class suits serve several important objectives. . . .

The most widely used class action statute is the 1966 version of Federal Rule 23, which governs the federal courts, as well as in several states. The rule sets out requirements in the first two subdivisions, and then in the remaining three sections provides guidance to the courts on how to manage class actions. These last sections include: notice provisions, setting forth when notice is required and what should be included (23(c)(2) and (d)(2)); authority for restructuring the action by subclassing (23(c)(4)), and for allowing absent members to intervene (23(d)(3)); and provisions for approving and controlling settlements (23(e)). *The focus is to encourage the development of flexible management devices and to provide the courts with some guidance in that area.*

The class requirements under Federal Rule 23 also are stated pragmatically. The party seeking class certification must show that the action meets the requirements set out in 23(a) and falls within one of the three categories of 23(b). The basic requirements in [23](a) are [impracticable joinder, common questions, and adequacy of representation are present]. . . . [T]he subdivision (b) categories . . . provide more guidance and with the intention that all class action judgments will be binding regardless of which type of suit is presented. Rule 23(b)(1) focuses on the possible adverse impact of a non-class judgment on the opposing party, who might be placed in an impossible position if faced with conflicting individual judgments, or on the absent class members, whose interests might be practically impaired if class action treatment were denied. Rule 23(b)(2) authorizes class suits in which injunctive or declaratory relief is appropriate on a class-wide basis. Rule 23(b)(3) allows class treatment if common questions predominate and if a class suit is the superior means of handling the controversy. *This last provision is the catchall and there is considerable discretion given to the court to determine superiority.*

Id. at 255, 260–61 (emphasis added).

212. See 15 U.S.C. § 78u-4(f)(2)(A). The joint and several liability provision reads: (A) Joint and several liability. Any covered person against whom a final judgment is entered in a private action shall be liable for damages

federal securities law violation can only be held proportionately liable under this provision of the PSLRA.²¹³ Ultimately, the practical effect of this provision is that if one particular corporate malefactor is insolvent, the plaintiff in a securities fraud litigation, after somehow navigating the minefield laid down by the PSLRA and being deemed victorious, may only be able to recover proportionately from other perpetrating firms and will be unable to recover full damages suffered as a result of the bankrupt company's fraud.

Finally, the PSLRA reforms the federal securities laws in a number of additional ways: broker-dealers are prohibited from taking fees from class-action lawyers for assisting in identifying class plaintiffs; terms of all proposed settlements must be fully disclosed; and attorneys' fees are restricted to "a reasonable percentage of the damages . . . actually paid to the class."²¹⁴

Once again, in enacting the PSLRA, the 104th Congress sought not only to fasten the doors tight against many federal class-action securities fraud plaintiffs,²¹⁵ but also to deter lawyers from bringing securities fraud cases,²¹⁶ to dispirit victims of securities fraud from finding an attorney and bringing a lawsuit,²¹⁷ to limit the availability of aiding and abetting claims against enabling firms and entities,²¹⁸ and to impose a variety of roadblocks against securities fraud class-action plaintiffs.²¹⁹ And, once an attorney, a victim, and/or a class had inexplicably surpassed each barrier imposed by the 104th Congress and the PSLRA and been deemed vanquisher in a lawsuit, any prospective damages claim against a bankrupt corporate bad actor was severely constricted by the elimination of the potential for joint and several liability.²²⁰

jointly and severally only if the trier of fact specifically determines that such covered person knowingly committed a violation of the securities laws.

Id.

213. *See id.* § 78u-4(f)(2)(B)(i). This section provides:

- (i) In general. Except as provided in subparagraph (A), a covered person against whom a final judgment is entered in a private action shall be liable solely for the portion of the judgment that corresponds to the percentage of responsibility of that covered person, as determined under paragraph (3).

Id.

214. *See* RATNER & HAZEN, *supra* note 60, at 271.

215. *See supra* note 139 (describing the attempted lock-down of available federal court relief available to victims of securities fraud after passage of the PSLRA); *see also infra* note 233 and accompanying text.

216. *See supra* notes 180–84 and accompanying text.

217. *See supra* note 184 and accompanying text.

218. *See supra* notes 197–204 and accompanying text.

219. *See supra* notes 205–11 and accompanying text.

220. *See supra* notes 212–13 and accompanying text.

Amidst the deregulation hysteria that gripped the 1994 Republican Revolution and the Contract with America, the Revolution Congress lowered its deregulatory hammer on the federal securities laws and rolled back protections that had been in place for dozens of years. Content to let corporate America and the U.S. capital markets regulate themselves in many areas, the 104th Congress removed constraints, liabilities, responsibilities, and disincentives from the securities laws. Chaos ensued.²²¹

The Revolution Congress cannot claim that it was not forewarned.²²²

C. Securities Litigation Uniform Standards Act of 1998

In order to avoid the super heightened pleading standard created by the PSLRA, some securities fraud plaintiffs were opting, after 1995, to bring their claims in state court, preferring instead to meet the pleading standards imposed by state blue sky laws.²²³ Congress, still infiltrated with Republican Revolutionaries, sought to foreclose this avenue by passing the Securities Litigation Uniform Standards Act of 1998 ("SLUSA").²²⁴ SLUSA requires that all securities class actions against nationally traded companies be brought in federal court, rather than in state court.²²⁵ As one commentator notes, SLUSA has fairly specific requirements: "essentially provid[ing] for federal preemption of state jurisdiction in class action law suits based on securities fraud where damages are sought on behalf of more than fifty persons and the securities involved are . . . listed on a national exchange or are . . . senior as nationally listed securities."²²⁶

D. The Effect of the PSLRA on the Securities Industry

Despite explicit warnings and detailed projections of the deleterious impact passage of the PSLRA would have on the U.S. capital markets,²²⁷ the Revolution Congress cavalierly passed the legislation

221. See *supra* notes 78–100; see also *infra* Part IV.

222. See *infra* section II.E.

223. See BABCOCK & MASSARO, *supra* note 128, at 324; see also Morrissey, *supra* note 203, at 834 ("Following the PSLRA's attempt to 'reform' securities litigation—or simply to limit it—a perception arose that securities fraud attorneys were avoiding the new limitations by bringing suit in state courts under more permissive state anti-fraud statutes and common law.").

224. Securities Litigation Uniform Standards Act of 1998, 15 U.S.C. § 78bb(f) (2000).

225. See BABCOCK & MASSARO, *supra* note 128, at 324 ("The special federal pleading rules for securities cases do not apply to state courts. In an effort to prevent investors from eluding [PSLRA] by filing in state court, Congress passed S. 1260, the Securities Litigation Uniform Standards Act of 1998.").

226. Morrissey, *supra* note 203, at 835.

227. See *infra* section II.E.

anyway.²²⁸ Following an unprecedented five-year increase in the capital markets from 1995 to 2000, the bubble burst in a spate of malfeasance, fraud, and deceit.²²⁹ One enduring legacy of the PSLRA and 1990s Revolution Congress deregulation will be the market crash of 2002.²³⁰ “Simply put, Congress reduced the incentives against committing fraud.”²³¹ Thus, the first effect of PSLRA’s impact on the securities industry was the market crash of 2002, which is described in some detail below.²³²

Another PSLRA effect is the arguable barricade that has been erected between securities fraud plaintiffs and the U.S. federal courts.²³³ One commentator plainly stated “You can’t get discovery unless you have a strong evidence of fraud, and you can’t get strong evidence of fraud without discovery.”²³⁴

[S]ince the 1995 [Public Securities Litigation Reform] Act [the U.S. Court of Appeals for the Ninth Circuit] *has thrown 18 consecutive securities fraud suits by investors out of court. Eighteen times in a row, using the 1995 Act, the Ninth Circuit has sided with corporate interests and closed the courthouse door*

228. *See supra* notes 10–12, 115–25.

229. *See supra* notes 46–53 and accompanying text.

230. *See infra* Part IV. The effects of the market crash of 2002 continued well into 2003, as the U.S. capital markets lurched around in fits and starts and the U.S. unemployment numbers continued to climb, despite sometimes-rosy predictions that the recession had ended. *See* Mark Gongloff, *Job Cut Announcements Up 43%*, CNN.COM, Aug. 5, 2003 (“U.S. job-cut announcements jumped in July [2003] to their highest level in three months, . . . another sign that the longest job-market slump since World War II continues. U.S. employers announced 85,117 job cuts in July, a 43 percent jump from 59,715 in June, according to Chicago-based outplacement firm Challenger Gray & Christmas, which publishes monthly tallies of job-cut announcements.”), at <http://money.cnn.com/2003/08/05/news/economy/layoffs/index/htm>.

231. Mikva, *supra* note 118, at 50. Mikva, in charging the Revolution Congress with “enabling fraud” writes:

The PSLRA created new, special legal immunities for misleading “forward looking” statements. . . .

The PSLRA also limited the liability of accountants who blew audits and of others who were found guilty of fraud. It elevated pleading requirements and made it harder to get normal court discovery, forcing defrauded shareholders virtually to make their entire case even before they went to court. Equally significant, lawmakers ignored the SEC’s request and rejected attempts to overturn two 5–4 Supreme Court decisions that had restricted the agency’s ability to fight securities fraud.

Id.

232. *See infra* Part IV.

233. *See* Hart, *supra* note 155, at 577 (describing the great difficulty securities fraud plaintiffs face in trying to secure discovery); *see also supra* note 139. *But see* Perino, *supra* note 121, at 929–36 (examining and seeking to explain the increase in securities fraud class-action filings after passage of the PSLRA); *see also* Wong, *supra* note 128, at 834.

234. Hart, *supra* note 155, at 577.

*to defrauded investors. Not one complaint out of 18 upheld or permitted to go forward!*²³⁵

Since the PSLRA strictures were enacted in 1995, at least through 2002, the Ninth Circuit has upheld dismissal of many if not most class-action securities fraud complaints that have come before it.²³⁶ Rarely has a plaintiff, in the view of the Ninth Circuit, been able to present a complaint that pled particularized facts that show a “strong inference” that each named defendant acted with a specific intent to defraud.²³⁷

Jarringly, *prior to the crash of 2002*, securities plaintiffs brought fraud lawsuits against WorldCom (in early 2000),²³⁸ Tyco (in late 1999),²³⁹ Arthur Andersen (in early 2000),²⁴⁰ and DeLoitte & Touche

235. Lerach, *supra* note 13, at 87; *see also supra* note 196.

236. *See* Lerach, *supra* note 13, at 87; *see also* Seligman, *supra* note 169, at 111–12 (“In large part because of the pleading standards in the [PSLRA], the federal circuits have dismissed a significant proportion of federal securities class actions on the basis of the complaint filed. An empirical study . . . of motions to dismiss under the 1995 Act between 1996 and 2001 found that the Ninth Circuit granted motions to dismiss in 61 percent of the cases.”).

237. *See* 15 U.S.C. § 78u-4(b)(2) (2000); *see also supra* notes 135–39. *But see* Perino, *supra* note 121, at 926–27 (noting that the Ninth Circuit has adopted the “most rigorous version” of the super heightened pleading standard and that most circuits have adopted an intermediate position between the Ninth Circuit’s standard (most rigorous) and the Second Circuit’s standard (least rigorous)). Professor Perino argues that some of his data suggests that the rigorous interpretation of the super heightened pleading standard by the Ninth Circuit has increased the quality and decreased the number of cases filed. *See id.* at 942.

238. *See In re MCI WorldCom, Inc., Sec. Litig.*, 191 F. Supp. 2d 778, 781 (S.D. Miss. 2002). In March 2000, fully two years before the WorldCom implosion, a shareholder securities fraud class-action suit was filed against MCI WorldCom and its management. *See id.* The U.S. District Court for the Southern District of Mississippi, constrained by the PSLRA pleading standard, dismissed the lawsuit in March 2002, finding that the alleged facts did not give rise to a strong inference of intentional misconduct or severe recklessness. *See id.* at 784. Three months later, in June 2002, the WorldCom bomb dropped. *See supra* notes 85–88, 88; *see also infra* section IV.C.

239. *See In re Tyco Int’l, Ltd., Sec. Litig.*, 185 F. Supp. 2d 102, 104 (D. N.H. 2002). In December 1999, fully two years before the Tyco calamity, a shareholder securities fraud class-action suit was filed against Tyco International and its management. *See id.* The U.S. District Court for the District of New Hampshire, constrained by the PSLRA pleading standard, dismissed the lawsuit in February 2002, finding that the plaintiffs needed to show more than mere motive and opportunity to commit fraud under the PSLRA. *See id.* at 110. Seven months later, in September 2002, members of Tyco management were indicted for securities fraud: “In September 2002, three top executives at Tyco, former CEO Dennis Kozlowski, former CFO Mark Swartz and former general counsel Mark Belnick were indicted on charges that they reaped \$600 million through a racketeering scheme involving stock fraud, unauthorized bonuses and falsified expense accounts.” *cummings, supra* note 8, at 1368 n.314 (quoting Andrew Ross Sorkin, *Two Top Executives Charged with \$600 Million Fraud Scheme*, N.Y. TIMES, Sept. 13, 2002, at A1). The N.Y. Times further reported that:

(in 1998),²⁴¹ and each lawsuit was dismissed by the federal courts.²⁴² Even though the deceit by WorldCom, Tyco, and Arthur Andersen was alleged far earlier than the eventual collapse date of each,²⁴³ under the heightened pleading standards of the PSLRA, the federal courts and the Revolution Congress comfortably sheltered each company, allowing them to continue to defraud U.S. investors for several additional years.²⁴⁴ Further, although both Arthur Andersen and

The authorities accuse Mr. Kozlowski and Mr. Swartz of stealing \$170 million from the company itself and reaping \$430 million more by covertly selling Tyco stock while “artificially inflating” the value of that stock. Tyco stock has fallen 70 percent in value this year. . . . The New York grand jury indictments . . . also accuse Mr. Kozlowski and Mr. [Swartz] of *bribing* a Tyco board member and several Tyco employees apparently to try to keep the scheme secret. The indictment accuses Mr. Kozlowski and Mr. [Swartz] of “enterprise corruption,” a charge often used in Mafia prosecutions.

Id. (emphasis added). In announcing the indictment, an SEC representative claimed: “Kozlowski, Swartz and Belnick treated Tyco as their private bank, taking out hundreds of millions of dollars of loans and compensation without ever telling investors Defendants put their own interests above those of Tyco’s shareholders. Those shareholders deserved better than to be betrayed by . . . management of the company they owned.” Allan Dodds Frank, *Kozlowski Hit with More Charges*, CNNMONEY.COM, Sept. 12, 2002, at <http://money.cnn.com/2002/09/12/news/companies/kozlowski/index.htm>.

240. See *In re Sunterra Corp.*, Sec. Litig., 199 F. Supp. 2d 1308 (M.D. Fla. 2002). In January 2000, fully two years before the Arthur Andersen meltdown, a shareholder securities fraud class-action suit was filed against Sunterra Corp., its management, and its accountant, Arthur Andersen. See *id.* The U.S. District Court for the Middle District of Florida, constrained by the PSLRA, dismissed the lawsuit in March 2002, finding that the complaint did not allege sufficient facts that would give rise to a strong inference that Arthur Anderson acted with the requisite state of mind, namely severe recklessness. See *id.* at 1337. Three months later, in June 2002, Arthur Andersen was convicted of obstruction of justice in the Enron fiasco. See E.A. Torriero & Robert Manor, *Jury Finds Anderson Guilty: Firm Says Verdict “Effectively Ends” Its Core Practice*, CHI. TRIB., June 16, 2002, at 1-1 (“In an inglorious end to its 89-year history as the country’s pre-eminent accounting firm, Chicago-based Andersen was convicted Saturday of obstruction of justice for interfering with a federal investigation of its failed client, Enron Corp.”).
241. See *In re Livent, Inc. Noteholders*, Sec. Litig., 151 F. Supp. 2d 371 (S.D.N.Y. 2001). In 1998, fully four years before DeLoitte & Touche’s client Adelphia was exposed for criminal fraud, a shareholder securities fraud class-action suit was filed against Livent, DeLoitte & Touche, and its management. See *id.* at 391. The U.S. District Court for the Southern District of New York, constrained by the PSLRA, dismissed the lawsuit in 2001, finding that the complaint did not allege facts that satisfied the requisite state of mind for some of the defendants. See *id.* at 384–85. In July 2002, DeLoitte & Touche client Adelphia was exposed for federal securities fraud, and Deloitte & Touche was under investigation for its role in the malfeasance. See *supra* notes 90–92; see also *infra* section IV.D.
242. See *supra* notes 238–41 and accompanying text.
243. See *infra* Part IV.
244. See SANFORD P. DUMAIN, AM. LAW INST.–AM. BAR ASS’N CONTINUING LEGAL EDUC., CLASS ACTION SUITS AND THE EFFECT OF THE PRIVATE SECURITIES LITIGA-

DeLoitte & Touche were recognized as enablers of the deception far earlier than the eventual collapse of the auditors or their clients, under the heightened pleading standards of the PSLRA, the federal courts and the Revolution Congress protected both accounting firms, allowing each to continue to enable corporations to defraud U.S. investors for several additional years.²⁴⁵ Had the WorldCom case been allowed to continue in early 2000, had the Tyco case been certified in 1999, or had Arthur Andersen or DeLoitte & Touche been exposed in the Sunterra or Livent litigation, the devastation that ensued for shareholders of each corporation may have decreased considerably, and perhaps the crash of 2002 could have been avoided or sharply muted. But the crash was not avoided, and the PSLRA is in part responsible.²⁴⁶

A third PSLRA impact was that the removal of specific regulatory protections gave corporations and firms *carte blanche* control over the information that they revealed to investors with no fear of reprisal or disincentive for dishonesty.²⁴⁷ The PSLRA (1) “raised the burden of proof for lawsuits against corporations that mislead shareholders—weakening an important deterrent against corporate fraud;”²⁴⁸ (2) may have “made accounting firms and law firms ‘sue proof’ for aiding and abetting securities fraud;”²⁴⁹ (3) provided “protection for baseless earnings projections,”²⁵⁰ particularly enabling Silicon Valley and the dot-com industry to explode and then collapse based on artificial value;²⁵¹ and (4) sent a strong signal to the U.S. capital markets and the global economy that “neither the regulators nor Congress has been looking out for investors.”²⁵²

TION REFORM ACT OF 1995, SH057 ALI-ABA 361, 373–74 (2003) (materials from continuing legal education seminar on February 6–7, 2003).

245. See *id.* at 381–83.

246. See *supra* notes 111–13 and accompanying text (reflecting the real life tragedy suffered by U.S. investors and employees of malfeasant corporations).

247. See *supra* section II.B.

248. See Lisa Girion, *1995 Tort Reform Act Said To Provide Safe Harbor for Fraud*, L.A. TIMES, July 21, 2002, at C-1. “We in 1995 said this is going to create fraud like we’ve never seen before, and I would say our predictions came true.” *Id.*

249. See Molly Ivins, *Energy Bills Would Worsen Things*, CHARLESTON GAZETTE, July 29, 2002, at 4A. “The 1995 Private Securities Litigation Reform Act is a little gem you should not miss. So easy to overlook, yet so damaging The bill . . . made it legal for CEOs to pipe up and lie about their company’s prospects.” *Id.*

250. Mike France, *This Crash Won’t Make Lawyers Rich*, BUS. WK., Mar. 26, 2001, at 147, 148. “Now that many of the more grandiose projections of the 1990s have fizzled, some people are wondering whether Congress gave Silicon Valley a little too much protection.” *Id.*

251. See Lerach, *supra* note 13, at 98–102 (detailing the stunning inaccuracies and reported falsehoods for dot-com IPOs in the 1990s).

252. Stephen Labaton, *Now Who, Exactly, Got Us into This?*, N.Y. TIMES, Feb. 3, 2002, at 3-1. “In 1995, [a] group of lawmakers and lawyers pushed successfully for leg-

While the Revolution Congress stiff-armed U.S. investors, choosing instead to cozy up to corporate America through enacting the PSLRA,²⁵³ the SEC stood idly by²⁵⁴ and allowed the largest deception in U.S. history to flatten U.S. investors and crush all investor confidence in the U.S. capital markets.²⁵⁵ Again, one enduring legacy of the PSLRA and Revolution Congress’s deregulation will be the market crash of 2002.²⁵⁶

E. Examination of Legislative History in Opposition to the PSLRA

The 104th Congress is culpable in significant part for the economic devastation that accompanied the stock market tumble of 2002; yet, the leaders of that Revolution Congress have escaped widespread blame and have certainly refused to accept any responsibility for the deregulation hysteria that led to many of the corporate collapses of 2001 and 2002.²⁵⁷ Indeed, many 104th Congressional leaders and other politicians have (or had) close ties to many of the worst corporate offenders.²⁵⁸ While Revolution Congress leaders duck responsi-

isolation that shielded companies and their accountants from investor lawsuits.” *Id.*

253. See *supra* notes 127–34.

254. See *supra* notes 76–98 and accompanying text; see also *cummings*, *supra* note 8, at 1306 n.3.

255. See *supra* notes 111–13 and accompanying text; see also *cummings*, note 8, at 1307 n.4.

256. See *supra* note 230 and accompanying text; see also *Browning*, *supra* note 52, at A1 (reporting that 9/11 had some impact on investor confidence during the market collapse in 2001 and 2002); *Kahn*, *supra* note 82, at 1582–84 (examining the role of terrorism and 9/11 in the capital market crash of 2002).

257. See *supra* notes 12–40 and accompanying text; see also *infra* sections IV.A–F.

258. See *Lavelle & Benjamin*, *supra* note 113, at 34 (“Last week, Enron teetered on the brink of bankruptcy, a perch few could have imagined just a few months ago. Not only one of the nation’s 10 largest companies, Enron was pioneer and master of the new competitive markets in energy. Its chief executive officer, Kenneth Lay, was a close friend of President Bush, a major campaign contributor, and an important adviser on the nation’s energy policy.”); see also *Follow the Enron Money*, CBSNEWS.COM, Jan. 13, 2002 (“More than 250 members of Congress—Democrats as well as Republicans—received political contributions from now-bankrupt Enron and at least 15 high-ranking Bush administration officials owned stock in the energy company last year, according to two government watchdog groups. Since 1989, Enron has made a whopping \$5.8 million in campaign donations, 73 percent to Republicans and 27 percent to Democrats.”), at <http://www.cbsnews.com/stories/2002/01/12/politics/main324142.shtml>; *Kevin McCoy, Enron’s Contribution Trail Reads Like a U.S. Road Map*, USA TODAY, Jan. 28, 2002, at 1B (“The energy-trading giant [Enron], whose sudden fall from *Fortune* 500 to bankruptcy court protection has set a benchmark for corporate collapses, doled out campaign contributions to state officials and candidates from coast to coast as the company battled for local deregulation laws. The spending, directed to Republicans and in lesser measure to Democrats, totaled at least \$1.88 million since 1998”); *Right to Know: White House Should Share What It Has on Enron Mess*, HOUSTON

bility²⁵⁹ and other politicians have desperately distanced themselves from the corrupt corporations,²⁶⁰ not one of the enabling politicians

CHRON., May 23, 2002, at A38 ("Vice President Dick Cheney, who made imprudent accounting changes when he headed Haliburton, the giant oil services company, will not reveal to the public he now serves which energy executive he met with while formulating the administration's national energy policy. Cheney, President Bush and other administration figures say they are proud of the energy policy they crafted. Why are they so ashamed of the process that produced it?"); Jim Yardley, *Bush Joined Unit of Enron in '86 Venture to Seek Oil*, N.Y. TIMES, Mar. 6, 2002, at C1 ("Enron's recent collapse into bankruptcy, however, has focused attention on the company's political connections, including those with Mr. Bush. For years, Enron gave campaign contributions to hundreds of officials, including nearly two-thirds of Congress. Mr. Bush was the biggest beneficiary, receiving hundreds of thousands of dollars from Enron and its former chairman, Kenneth L. Lay, since 1994."). See also Christopher H. Schmitt, *Bush and Cheney's Not-So-Excellent Adventures, A La Enron*, U.S. NEWS & WORLD REP., July 22, 2002, at 28. Schmitt reports in the *U.S. News and World Report*:

Aggressive accounting to boost profits. Failure to promptly disclose insider stock trading. Bailing out with big gains before a stock swoon. Disguising losses through bogus deals with fellow executives. Such charges have been leveled at Enron's Kenneth Lay, WorldCom's Bernard Ebbers, and ImClone's Samuel Waksal. But also, it turns out, at President Bush and Vice President Cheney.

Id.

259. See Girion, *supra* note 248, at C-1. In 2002, Girion reported:

"We in 1995 said this [passage of the PSLRA] is going to create fraud like we've never seen before, and I would say our predictions came true," said Sally Greenburg, a lawyer for Consumers Union. Yet Lawmakers, poised to send to the White House the most sweeping financial reforms since the 1930s [the Sarbanes-Oxley Act], have rebuffed efforts to restore most shareholder rights lost to securities tort reform. Many of the lawmakers, both Democrat and Republican, who supported the legislation several years ago remain in Congress and continue to back their handiwork.

Id.; see also Labaton, *supra* note 252, at 3-1. In early 2002, Labaton reported:

Mr. Dodd [D-Connecticut] said last week that "as a general proposition" Congress ought to re-examine the 1995 legislation [PSLRA] as well as other rules in light of Enron, but that he also thought the 1995 law had done more good than harm.

"If the point is to blame what happened on this law, it is totally misplaced," he said. "The goal of the bill was to deter frivolous lawsuits—not lawsuits, but frivolous lawsuits. And our goal was to not hold one guy totally responsible for something that he may be only marginally responsible for."

Id.

260. See Schmitt, *supra* note 258, at 28 ("The White House has dismissed these questions [of corporate improprieties in pre-White House business transactions] and, by 1990s-bubble standards, the amounts involved aren't huge. Nor is their proof of wrongdoing. But, says Paul Brown, accounting department chairman at New York University's business school, 'you can't help but suggest that [there] has to be some looking in the mirror for events of the past.'").

can deny that the warning bell rang loud and clear prior to passage of the PSLRA.²⁶¹

President Clinton vetoed the PSLRA, returning the legislation with stark warnings that the Act would have a deleterious effect on the securities markets and on U.S. investors.²⁶² President Clinton’s veto was motivated in large part by the Revolution Congress’s efforts to place unprecedented pleading standard requirements on victims of securities fraud, while promulgating numerous provisions that foreclose securities fraud plaintiffs from gaining access to their constitutionally assured “day in court.”²⁶³

Senator Sarbanes, the coauthor of the Sarbanes–Oxley Act—legislation meant to clean up after the PSLRA and Revolution Congress deregulation fiasco²⁶⁴—also voiced strong disapproval to enactment of the PSLRA:

Mr. President, later today the Senate will vote on the final version of the securities litigation bill which has been brought back from conference. Supporters of the bill argue that it is a balanced response to a widespread problem; namely, frivolous securities litigation. What should be clear to all Senators, however, is that this bill is not a balanced response to that problem.

This legislation will affect far more than frivolous suits. . . . *This bill will make it more difficult for investors to bring and recover damages in legitimate fraud actions.* . . .

At every stage of the legislative process, this bill has been amended to make it more difficult for investors to bring legitimate suits. As it has moved through the process, provisions favorable to investors have been taken out. Balanced provisions in the legislation have been made harmful to investors. *Individual investors, local governments and pension plans all will be hurt by this legislation.*²⁶⁵

In Senator Sarbanes’ statement from the Senate floor, the Senator painstakingly addressed nearly every provision of the PSLRA and pointed out the flaws in each section, carefully describing the ways in which the PSLRA would injure small investors and would lead to seriously fraudulent behavior by corporate executives.²⁶⁶ In retrospect, Senator Sarbanes appears extrasensory in forecasting the difficulties

261. See *infra* notes 266–83 and accompanying text (describing the serious warning delivered from a variety of sources that the PSLRA would lead to corruption and vice).

262. See *supra* notes 123–25 and accompanying text.

263. See *supra* note 124 and accompanying text.

264. See *infra* Part V.

265. 141 CONG. REC. 35,241 (1995) (statement of Senator Sarbanes) (emphasis added). “All will find it more difficult to bring fraud actions and to recover full damages as a result of the measure now before the Senate. That is why this bill is opposed by a broad coalition of regulators, State and local government officials, labor unions, consumer groups and investor organizations, and by literally dozens and dozens of editorials in major newspapers and magazines across the country.” *Id.*

266. See generally 141 CONG. REC. 35,241–47 (1995) (statement of Senator Sarbanes).

that individual investors, pension funds, and local governments would suffer if the PSLRA was enacted as proposed.²⁶⁷

To support his position that the PSLRA was an ill-conceived proposition and one that slanted the field in the favor of corporate insiders at the expense of U.S. investors, Senator Sarbanes cited a variety of editorials that predicted the downfall of the U.S. capital markets if the federal securities laws were deregulated as proposed.²⁶⁸ The *Bangor (Maine) Daily News* reported:

Among the most dramatic but least discussed spin-offs of the Contract With America is securities litigation reform legislation, which earlier this year quietly passed both houses of Congress in different forms, but this week could become part of a public spectacle, highlighted by a presidential veto.

House Republicans argued in the contract . . . that accumulated legal abuses cost American consumers \$300 billion a year. Proponents characterize H.R. 1058 and S. 240, the two bills on which a conference compromise of the Securities Litigation Reform Act is expected to be voted on this week, as antidotes to costly, frivolous lawsuits pursued by greedy lawyers.

Opponents believe the critical elements of both bills, but especially as reflected in the conference version, are destructive of consumer interests. In the best Washington hyperbole, they refer to it as "The Crooks and Swindlers Protection Act" because of the manner in which it tilts the courtroom in favor of corporate defendants in securities and fraud cases.

267. See 141 CONG. REC. 35,243 (1995) (statement of Senator Sarbanes). Senator Sarbanes observed:

The [PSLRA] limits joint and several liability under the Federal securities law to certain defendants, specifically excluding defendants whose conduct was reckless. The bill, thus, reduces the accountability of accountants and attorneys whose conduct is found to be reckless. This change will hurt investors in cases where the principal framer of the fraud is bankrupt, has fled, or otherwise cannot pay investors damages. In those cases, the innocent victims of fraud will be denied full recovery of their damages.

Id. Senator Sarbanes further predicted:

[L]et me now turn to the so-called safe harbor provision, and I underscore "so-called." This bill creates a statutory exemption from liability for forward-looking statements. Forward-looking statements are broadly defined in the bill to include both oral and written statements. Examples include projections of financial items such as revenues and income for the quarter or for the year, estimates of dividends to be paid to shareholders, and statements of future economic performance, such as sales trends and development of new products. In short, forward-looking statements include precisely the type of information that is important to investors deciding whether to purchase a particular stock.

The SEC currently has a safe harbor regulation for forward-looking statements that protects specified forward-looking statements that were made in documents filed with the SEC.

. . . I remain concerned that the safe harbor provision before us today will, for the first time, provide protection for fraudulent statements under the Federal securities laws. For the first time, fraudulent statements will receive protection under the Federal securities laws.

141 CONG. REC. 35,243 (1995) (statement of Senator Sarbanes); see also *supra* notes 172-78 and accompanying text.

268. See generally 141 CONG. REC. 35,244 (statement of Senator Sarbanes).

....
 The Securities Litigation Reform Act has the potential to save consumers nothing, protect white-collar criminals and add to the burden of the victims of fraud.²⁶⁹

The *Miami Herald*, in decided opposition to the PSLRA, editorialized:

While most of the country is paying attention to the feud over the federal budget, a sinister piece of legislation is making its way through Congress unnoticed. This bill lets companies report false information to investors. That’s right, it essentially licenses fraud. It has passed both houses in slightly different forms. A compromise bill will be written soon. If it passes, President Clinton ought to slay it in its tracks

This bill evidently struck many members of Congress as a simple answer to a nagging problem [frivolous securities fraud lawsuits]. It’s nothing of the kind. The problem is real enough, but its solution isn’t simple. And it certainly doesn’t reside in a law authorizing phony statements to investors.²⁷⁰

Finally, following PSLRA congressional debate, the *San Francisco Chronicle* opined:

In a letter asking Clinton to veto the [PSLRA], San Francisco’s chief administrative officer, Bill Lee, noted that the legislation would “erode investor protections in a number of ways: it fails to restore the liability of aiders and abettors of fraud for their actions; it limits many wrongdoers from providing full compensation to innocent fraud victims, by eroding joint and several liability; it could force fraud victims to pay the full legal fees of large corporate defendants if they lose; it provides a blanket shield from liability for companies that make knowingly fraudulent predictions about an investment’s performance and risks; and it would preserve a short, three-year statute of limitation for bringing fraud actions, even if fraud is not discovered until after that time”

As the draft report stands, investors would be the losers. And their hopes of receiving convictions in suits similar to those against such well-known con men as Michael Milken and Ivan Boseky would be severely hampered.²⁷¹

Representative John Dingell (D-Michigan) starkly opposed passage of the PSLRA, offering that it would only “marginally deter frivolous lawsuits while causing significant harm to investors with meritorious claims.”²⁷² In support of his strong opposition to the PSLRA, Representative Dingell submitted to the Congressional Record two articles that pointed to the serious flaws inherent in the Act. The first stated:

A securities law aimed at reducing frivolous lawsuits also may make it harder for investors with legitimate claims.

....
 Because efforts to stretch the statute of limitations failed, investors must continue to check their investment account statements promptly for irregular-

269. *Do No Harm*, BANGOR DAILY NEWS, Nov. 30, 1995.

270. *Liars’ Bill of Rights*, MIAMI HERALD, Nov. 14, 1995.

271. *Opening the Door to Fraud*, SAN. FRAN. CHRON., Nov. 27, 1995, at A18.

272. 141 CONG. REC. 36,944 (1995) (statement of Representative Dingell). Representative Dingell, in his strong opposition to House of Representatives approval of the PSLRA, stated: “Mr. Speaker, on December 6, 1995, the House passed the conference report on H.R. 1058, the Private Securities Litigation Reform Act of 1995. I am disappointed that the House approved this legislation.” *Id.*

ities. They also must carefully document problems and consult a lawyer quickly

But it may be hard to find a lawyer to take investor fraud cases. "The law tells us we can't just have a good case, we must have a great case," says Matthew Kelly, a lawyer who represents investors at Roemer, Wallens & Minneaux in Albany, N.Y.²⁷³

The Bond Buyer, reporting on municipalities' concern that the PSLRA would devastate local government's efforts to recover for securities, stated:

The California State Association of Counties on Friday elected a new president—San Mateo County supervisor Mike Nevin—whose first action was sending a letter to President Clinton opposing the Securities Litigation Reform Act.

CSAC, a nonprofit corporation that promotes the interests of California's 58 counties before the state legislature and Congress, contends the [PSLRA] will severely hinder local governments' ability to recover losses related to securities fraud.

"We need to have the ability to recover losses in the case of securities fraud," Nevis said yesterday. . . .

The letter to Clinton was signed by 106 county and other local government officials. . . .

"Local governments are victims of securities fraud; they need access to the courts to recover their losses," [said Steve Szalay, executive director of CSAC.] "Orange County, on behalf of 187 independent California governments, is suing to recover about \$1.5 billion on the grounds that the investments made on its behalf were unsuitable and violated the California constitution and statutes."

"This bill makes it very difficult for local governments and taxpayers to recover their losses in securities fraud cases, and it will give wrongdoers a green light to commit more fraud, Szalay said."²⁷⁴

Despite a veto from President Clinton,²⁷⁵ strong opposition from state and local governments and municipalities,²⁷⁶ serious opposition from dozens of editorializing newspapers and magazines,²⁷⁷ stout opposition from leading Congresspersons with expertise in the corporate arena,²⁷⁸ a sharply worded letter of opposition signed by the Attorneys General of eleven different states,²⁷⁹ heavy opposition from the

273. Christine Dugas, *Securities Lawsuit Bill May Hurt Investors*, USA TODAY, Dec. 8, 1995, at 4B.

274. Joe Bel Bruno, *California Counties Ask Clinton To Veto Securities Bill*, THE BOND BUYER, Dec. 5, 1995, at 11.

275. See *supra* notes 123–25 and accompanying text.

276. See *supra* note 274 and accompanying text; see also *infra* note 279 and accompanying text.

277. See *supra* notes 268–71, 273 and accompanying text (quoting several major U.S. newspapers editorializing against enactment of the PSLRA).

278. See *supra* notes 264–67 and accompanying text (detailing the stalwart opposition to the PSLRA of Senator Sarbanes, the architect of the Sarbanes–Oxley Act.).

279. See 141 CONG. REC. 35,247 (1995) (statement of Senator Sarbanes). In a letter to President Clinton, authored by Tom Udall, the Attorney General of New Mexico, and signed by the Attorney General of 10 other states, Mr. Udall proclaimed:

AFL-CIO,²⁸⁰ grave opposition from the Fraternal Order of Police,²⁸¹

As Attorneys General of our respective states, we strongly oppose H.R. 1058/S240, the Securities Litigation Reform Act. The “draft conference report,” which is the basis of agreement between the House and Senate bills, *would severely penalize victims of securities fraud—consumers, workers, senior citizens, state and local governments. The principal effect of this legislation would be to shield wrongdoers from liability for securities fraud committed against an unsuspecting public. . . .*

If enacted, this legislation would severely curtail our efforts to fight securities fraud and to recover damages for our citizens if any of our state or local funds suffer losses due to fraud. There are several provisions in both bills that would make it exceedingly difficult, if not impossible, for consumers and state and local governments to use the federal courts to recoup losses due to fraud. . . .

As our states’ chief law enforcement officers, we cannot countenance such a weakening of critical enforcement against white-collar fraud. Private actions, as a complement to government enforcement, have proven to be extremely effective in deterring securities fraud and in compensating injured investors. This longstanding practice has deterred even greater fraud in the markets and has reduced the burdens that would otherwise accrue as a result of the government having to fully police the markets.

Id. (emphasis added).

280. See 141 CONG. REC. 35,246 (1995) (statement of Senator Sarbanes). In a letter to U.S. Senators, the American Federation of Labor, Congress of Industrial Organizations (“AFL-CIO”) expressed strong opposition to the PSLRA and predicted that fraudulent behavior from corporate executives would increase and that victims of securities fraud would be left with no remedies:

The AFL-CIO opposes the conference agreement on H.R. 1058, the Securities Litigation Reform Act of 1995. The conference agreement significantly weakens the ability of stockholders and pension plans to successfully sue companies which use fraudulent information in forward-looking statements that project economic growth and earning. There is a new “safe harbor” provision in this conference agreement that allows evidence of misleading economic information to be discounted in court if it is accompanied by “appropriate cautionary language.”

The AFL-CIO believes this compromise will vastly increase the difficulties that investors and pension plans would have in recovering economic losses. Similarly, the joint and several liability provisions in this bill provide added, and unwarranted, protection for unscrupulous companies, stockbrokers, accountants and lawyers.

In short, this bill tips the scales of justice in favor of the companies and at the expense of stockholders and pension plans. Both of these latter groups are forced to rely exclusively on information provided by these companies when evaluating a stock, but this information would not be able to be used in court to recover economic damages for misleading information.

Id.

281. See 141 CONG. REC. 35,247 (1995) (statement of Senator Sarbanes). In a letter to President Clinton, the Fraternal Order of Police, National Legislative Program strongly urged rejection of the PSLRA because it favored corporate criminals:

On behalf [of the] National Fraternal Order of Police, I urge you to veto the “Securities Litigation Reform Act” (HR 1058/S240). The recently released draft of the House/Senate conference report clearly reflects a dramatic reduction in the ability of private, institutional and government investors to seek redress when victimized by investor fraud.

and somber warnings of future capital market devastation,²⁸² the Revolution Congress passed the PSLRA, with a significant assist from corporate executives and their lobbyists.²⁸³ The market crash of 2002 has undoubtedly curbed any joy felt in the corporate world at the time the PSLRA was enacted. Certainly, no glory can be found in the PSLRA when the pain of employee and investor losses from the market collapse of 2002 is so fresh.

Unfortunately for U.S. investors and employees, the PSLRA was not the only reform and deregulatory effort undertaken by the Revolution Congress, and the havoc wreaked by the PSLRA is not the only destructive influence that enabled the market tumble of 2002. The 104th Congress, soon after swiftly passing the PSLRA, turned its deregulation jackhammer toward the telecommunications industry, and, again, acted improvidently.

III. OTHER 1990s DEREGULATION

A. The 1996 Telecommunications Act

After gunning down decades-old securities fraud protections in 1995, with passage of the PSLRA, the Revolution Congress turned its attention to the previously staid telecommunications industry. Since 1934, the telecommunication industry had been carefully regulated, some would argue successfully,²⁸⁴ but the regulation had become in-

As a matter of fact, the single most significant result of this legislation would be to create a privileged class of criminals, in that it virtually immunizes lawyers, brokers, accountants and their accomplices from civil liability in cases of securities fraud. . . .

Mr. President, our 270,000 members stand with you in your commitment to a war on crime; the men and women of the F.O.P. are the foot soldiers in that war. On their behalf, I urge you to reject a bill which would make it less risky for white-collar criminals to steal from police pension funds while the police are risking their lives against violent criminals.

Id. In 1995, Gilbert Gallegos, the National President of the Fraternal Order of Police, worried that the PSLRA would allow freewheeling white-collar crime, at the expense small U.S. investors, all while his U.S. police personnel were out risking their lives protecting the white-collar criminals from violent crimes. *See id.* The irony of the F.O.P. President's position and the reality of his situation today is painful.

282. *See supra* section II.E.

283. *See supra* notes 119–20 (detailing the actual roll-call votes by which the PSLRA passed the House and Senate and the roll-call vote that overrode the Presidential Veto).

284. Interview with Tom Stephens, Qwest Communications, Member, Board of Directors, in Denver, Colorado (July 2003) (The 1996 Telecommunications Act “created competition and chaos.”) (interview conducted by research assistant Leigh Wald) (interview notes on file with author).

creasingly criticized as outdated and inadaptable.²⁸⁵ The 104th Congress, determined to radically unravel the regulatory structure of the telecommunications industry, overwhelmingly passed the Telecommunications Act of 1996.²⁸⁶ The Telecommunications Act uncompromisingly and inattentively sought to reform "the *whole* of telecommunications law, not just one specific aspect of it."²⁸⁷ Passage of the Telecommunications Act, following hotly on the heels of the passage of the PSLRA, further deregulated segments of corporate America, creating an environment ripe for corruption and easy deception of the investing public.²⁸⁸

B. The Commodities Futures Modernization Act of 2000

After annihilating decades-old securities fraud protections in 1995 with passage of the PSLRA, and after rewriting decades-old telecommunications laws with passage of the Telecommunications Act in 1996, the Revolution Congress directed its attention, or in some cases inattention, to the energy, electricity, and derivatives trading industries as its next targets.²⁸⁹ "During the 105th Congress, lawmakers held 20 hearings on how to deregulate the \$208 billion electric power industry, embarking on what some said would shape up to be the biggest lobbying battle of the decade."²⁹⁰ Energy deregulation proponents promised that deregulation would lead to "vigorous competition" between energy and electricity producers and that such "vigorous competition will benefit all consumers, large and small."²⁹¹ Revolution

285. See Lawrence Gasman, *The Telecommunications Act of 1996*, 1996 REGULATION: THE CATO REV. OF BUS. & GOV'T 49, 49.

286. See Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56.

287. See Gasman, *supra* note 285, at 49.

288. See cummings, *supra* note 31.

289. See generally Kathryn Kranhold, *As Deregulation Moves into the Electricity Market, the Changes Promise to Be Dramatic—and Confusing*, WALL ST. J., Sept. 14, 1998, at R4 ("In fact, as the U.S. begins its journey into electricity deregulation, probably only one thing can be predicted with any certainty: It's going to be an awfully confusing couple of years.").

290. Deirdre Shesgreen, *Lobbying Bonanza: Lobbyists Say Unfinished Congressional Business Is the Best Kind: Unfinished Business Is Good for Business for Many of Washington's Biggest Lobbying Firms*, PALM BEACH DAILY BUS. REV., Jan. 2, 1998, at A1. The *Palm Beach Daily Business Review* reports that the Revolution Congress's attempts to deregulate the electric power industry ran aground in 1997 due in large part to massive campaign contributions from "electric utilities, independent power generators, and rural electric co-operatives." *Id.* "In the first six months of 1997, electric utilities, independent power generators, and rural electric cooperatives poured \$2.4 million into politicians' campaign coffers, according to the Center for Responsive Politics. Energy groups spent \$37 million on lobbying in the first half of 1996 and continued that spending apace into 1997, according to Roll Call, the Capital Hill newspaper." *Id.*

291. See Kranhold, *supra* note 289, at R4. Nevertheless, critics staunchly refute such rosy predictions from deregulation proponents:

Congress attempts to deregulate the electric power industry eventually broke down in 1997.²⁹²

In the wake of the breakdown of Congressional efforts to deregulate the electric power industry, Brooksley Born, the then-head of the Commodity Futures Trading Commission²⁹³ ("CFTC") proposed in 1998 that she "explore whether more regulation was needed for over-the-counter derivatives."²⁹⁴ The value of the over-the-counter derivatives market "had grown fivefold to \$29 trillion in the six years since [federal] regulators had last considered regulating the financial instruments" in 1992.²⁹⁵ While Director Born met with early resistance from the Treasury Secretary and the Federal Reserve Board Chair-

But critics fear that the benefits will be uneven at best. And some aren't so sure that the competition will be all that vigorous: Deregulation has already led to rapid consolidation among utilities, critics note, and that could lead to diminished competition and higher prices down the line.

Indeed, leaving energy prices to the vagaries of the market still unnerves some critics of deregulation, and many fear that the potential benefits don't necessarily justify the uncertainty.

Id.

292. See Shesgreen, *supra* note 290.

293. In *Chicago Mercantile Exchange v. SEC*, 883 F.2d 537 (7th Cir. 1989), Judge Easterbrook describes the jurisdiction and authority of the CFTC as follows:

The Commodity Futures Trading Commission has authority to regulate trading of futures contracts (including futures on securities) and options on futures contracts. The Securities and Exchange Commission has authority to regulate trading of securities and options on securities. If an instrument is both a security and a futures contract, the CFTC is the sole regulator because "the Commission shall have exclusive jurisdiction with respect to . . . transactions involving . . . contracts of sale (and options on such contracts) for future delivery of a group or index of securities (or any interest therein or based upon the value thereof)[.]" If however, the instrument is both a futures contract and an option on a security, then the SEC is the sole regulator because "the [CFTC] shall have no jurisdiction to designate a board of trade as a contract market for any transaction whereby any party to such transaction acquires any put, call, or other option on one or more securities . . . including any group or index of such securities, or any interest therein or based on the value thereof."

Id. at 539 (citation omitted) (quoting 7 U.S.C. § 2).

294. Jacob M. Schlesinger, *The Deregulators: Did Washington Help Set Stage for Current Business Turmoil?*, WALL ST. J., Oct. 17, 2002, at A1.

295. See *id.* Derivatives and over-the-counter derivative trading

derive their value from price shifts in underlying assets, such as the interest on a bond, the value of a currency or the price of a barrel of oil. Multinational corporations, for example, use derivatives as a hedge, to protect themselves against sudden swings in the value of the dollar.

Id. See generally JOHN C. COFFEE & JOEL SELIGMAN, SECURITIES REGULATION: CASES AND MATERIALS 15 (9th ed. 2003) (defining derivatives as "contractual instruments that derive their value from the values of underlying instruments or commodities upon which they are based").

man,²⁹⁶ she feared that “leaving the derivatives unregulated . . . carried huge risks.”²⁹⁷ Director Born’s fears were justified in that:

Over-the-counter derivatives were traded directly between companies, away from regulated futures exchanges. Because they weren’t subject to rules that applied to other securities, little was disclosed about the transactions. That made it easier for traders to take big risks, or fraudulently manipulate deals. Derivatives had contributed to some spectacular blowups, including the bankruptcy of Orange County, Calif., and the demise of 233-year-old Barings PLC, which went belly up in 1995 after a rogue trader lost \$1 billion in unauthorized derivatives trades.²⁹⁸

Determined to provide a safe haven for investors and shareholders, Director Born and the CFTC conducted and released a study, styled a “concept release,” that raised questions as to the integrity of the over-the-counter derivatives trading market and the lack of federal regulation appurtenant thereto.²⁹⁹ U.S. financial leadership, together with the SEC, “rushed out a statement” within hours of the release of the CFTC’s “concept release” that expressed “grave concerns” about the study.³⁰⁰

Ultimately, Director Born was quashed by Congress. Under a dizzying lobby barrage, led by energy giant Enron, amongst others,³⁰¹ the corporate interests convinced Congress in 2000 to pass the Commodity Futures Modernization Act. The CFMA introduced the most dramatic and sweeping changes in commodity futures market regulation since the phenomenon of commodity futures trading began seventy-eight years earlier, but it failed therein to regulate over-the-counter derivatives trading.³⁰² Such failure to regulate over-the-

296. See Schlesinger, *supra* note 294, at A1. Schlesinger reported that at the time Director Born was seeking to introduce regulation into over-the-counter derivative trading, she was warned that she would disrupt the capital markets:

[Treasury Secretary Robert] Rubin was a former co-chairman of Goldman, Sachs & Co. whose major political achievements included making Wall Street and business executives comfortable with Democrats and persuading President Clinton to balance the federal budget. He took seriously Wall Street’s complaints that even the threat of regulation could void pending transactions. Mr. Greenspan believed that innovative derivatives were making the economy more efficient by providing companies with a hedge against financial fluctuations.

Id.

297. *Id.*

298. *Id.*

299. *See id.*

300. *Id.*

301. *See id.* (“Wall Street went into lobbying overdrive, as leading derivatives underwriters such as J.P. Morgan, heavy derivatives users like Enron, and nearly a dozen financial trade groups pleaded with the Fed and Treasury to stop Ms. Born.”).

302. *See HAZEN & RATNER, supra* note 67, at 96–97. Hazen and Ratner described the CFMA as:

eliminat[ing] the longstanding ban on securities futures contracts. In doing so, the Act established a co-regulatory system under which the

counter derivatives trading allowed an environment to exist where energy and telecom companies such as Enron and Global Crossing could engage in wildly speculative over-the-counter trading of derivatives.³⁰³

IV. IS DEREGULATION RESPONSIBLE FOR THE STOCK MARKET COLLAPSE OF 2002?

The primary question this Article examines is whether federal deregulation and reform in the 1990s, particularly the PSLRA, can be blamed for the collapse of the U.S. capital markets in 2001 and 2002. The answer, in a word, is yes. While a variety of other factors must be included when searching for reasons the market collapsed,³⁰⁴ one of the primary underpinning reasons the collapse occurred can be traced directly to the deregulation hysteria that gripped Congress throughout the mid-1990s.³⁰⁵ To wit:

A. Enron

At the time that Enron imploded, the securities industry and investing public were stunned at the size and scope of the deceptions that Enron's management had perpetrated.³⁰⁶ The massive failure of the Enron Corporation very well may represent an unparalleled corporate collapse in United States history. As a number of commentators have noted:

[i]t seems hard to believe now, but Enron (ENE) used to be the envy of corporate America. In less than a decade, the Houston company transformed itself from stodgy gas-pipeline operation to natural gas and electricity trading pow-

SEC and CFTC coordinate their regulatory oversight over securities futures. A securities future is defined as a security, which makes the Securities Exchange Act of 1934 generally applicable to trading of securities futures products. Securities futures can be traded only on common stock registered under Section 12 of the Securities Exchange Act of 1934. Those securities are subject to the detailed periodic reporting requirements generally applicable to publicly traded securities.

The CFMA permits trading of securities futures either on a national securities exchange registered with the SEC or a commodities contract market that is registered with the CFTC.

Id. (footnotes omitted).

303. See cummings, *supra* note 31.

304. See HAZEN & RATNER, *supra* note 67, at 85–91, 105–18; see also OM MALIK, BROADBANDITS: INSIDE THE \$750 BILLION TELECOM HEIST ix–xvii (2003) (citing “[f]ear of falling stock,” “[t]he cult of the CEO,” and “[h]ypergrowth” as reasons for the bust of the telecommunications industry); *supra* notes 52, 256 (discussing the impact of 9/11 on the U.S. capital markets); *infra* notes 320–21.

305. See *infra* section I.A; see also Lee & Mande, *supra* note 107, at 99–105 (documenting the instantaneous decrease in audit quality of the Big Six accounting firms following adoption of the PSLRA as evidenced by the prevalence of increasing discretionary accruals).

306. See Lisa Gibbs et al., *Enron: The Lessons for Investors*, MONEY, Jan. 2002, at 30.

erhouse. Dazzled by sizzling earning growth, giddy investors bid up Enron’s shares 312% in two years to a high of \$90.75 in 2000. Then someone turned out the lights. Beset by marketplace woes and management mishaps, the stock already had tumbled 53% when chief executive Jeffrey Skilling stunned investors by resigning last August. After that, the bad news came at hyper-speed: \$1.2 billion in shareholder equity zapped by risky hedging deals, a Securities and Exchange Commission probe, a last-chance merger with rival Dynegy called off and, finally, a bankruptcy filing. By the end of November [2001], the stock had plummeted to 26 [cents], obliterating \$67 billion in market cap—a shocking fall for a company that just last year occupied the No. 7 spot on the Fortune 500.³⁰⁷

Perhaps most stunning were the initial denials of any knowledge of impending doom asserted by Enron’s board of directors and key management.³⁰⁸ Belying Enron management’s professed ignorance to circumstances leading up to its scandalous collapse is the U.S. Senate report that found that the Enron board of directors clearly knew of Enron’s “high-risk accounting and off-the-books deceptions.”³⁰⁹ The Senate report further determined that “[t]he board witnessed numerous indications of questionable practices by Enron management over several years, but chose to ignore them to the detriment of Enron shareholders, employees and business associates.”³¹⁰

Further belying Enron management’s professed ignorance were various reports that identified several Enron executives who took enormous cash bonuses and sold large portions of Enron stock immediately prior to the company’s collapse.³¹¹ When Enron filed for bankruptcy on June 18, 2002, records and court documents indicated that:

In the year before the Enron Corporation collapsed last December, about 100 executives and energy traders collected more than \$300 million in cash payments from the company, according to documents filed today [June 18, 2002] in bankruptcy court. More than \$100 million . . . went to Kenneth L. Lay, the company’s former chairman and chief executive. A majority of the cash pay-

307. *Id.* Despite Enron’s implosion and mounting evidence to the contrary, various executives and management figures continually denied knowledge of an impending doom awaiting Enron. *See id.* at 31 (“When pushed to reveal more, management was often tight-lipped and unprofessional. During one famous conference call last April [2001], [CEO] Skilling called an analyst an ‘asshole’ for complaining about the company’s failure to provide a balance sheet with its earnings announcement.”); *see also* cummings, *supra* note 8, at 1314 n.17; *supra* notes 80–83 and accompanying text.

308. *See* Carrie Johnson, *Senate Report Criticizes Enron Board in Collapse*, CHI. TRIB., July 7, 2002, at A-11 (“The members of Enron Corp.’s board of directors contributed to the company’s collapse by failing to curb the Houston energy trader’s risky accounting tactics, approving conflicts of interest, and rubber-stamping enormous cash payouts to executives, according to a harshly worded Senate report to be released Sunday.”).

309. *See id.*

310. *Id.*

311. *See* David Barboza, *Officials Got a Windfall Before Enron’s Collapse*, N.Y. TIMES, June 18, 2002, at C1.

ments went to employees of units whose profitability has been called into question since the company's collapse. . . .

The disclosure of scores of large cash payments is certain to increase the ire of former lower-level employees who have long complained about how high-level executives sold more than \$1 billion in Enron shares in the year [from July 2001 to June 2002] before the company filed for bankruptcy protection. . . .³¹²

Enron management, in a complex hybrid of subsidiary creation, partnership alliance, and energy derivatives trading, was able to deceive the investing public, and its employees, to the tune of billions of dollars of nonexistent value.³¹³ Only those intimately familiar with the inner workings of the company were aware of the massive deceptions that were being played out daily by Enron officers.³¹⁴ Since the initial astonishment at Enron's brazen activities has passed, several of the top management figures in the company's disintegration have been arrested and charged with securities fraud and other crimes.³¹⁵

312. *Id.* "Yet even as the company was hurtling toward bankruptcy, some . . . executives were showered with huge retention bonuses worth nearly \$100 million" *Id.*

313. *SEC Chairman Pitt Testifies on House Enron Reform Bill*, Corporate Secretary's Guide (CCH) No. 337, at 52 (Apr. 9, 2002) (detailing the fall of Enron as it involved derivatives trading where Enron was compared to an over-the-counter ("OTC") derivatives trading firm operating within a "regulatory black hole"). While testifying before the Senate Governmental Affairs Committee, charged with peeling back the layers of the Enron deception, University of San Diego law professor Frank Partnoy testified that "some Enron employees systematically used 'dummy accounts' and 'rigged valuation methodologies' to create false profit and loss entries for the derivatives Enron traded." *Id.* Professor Partnoy continued by testifying "that the OTC derivatives markets are largely *unregulated* and Enron's trading operations were not *regulated*, or even recently audited, by securities regulators." *Id.* (emphasis added). Professor Partnoy described Enron's complex use of deregulated derivatives trading as follows:

Specifically, Enron used derivatives and special purpose vehicles to manipulate its financial statements in three ways. First, it hid losses it suffered on technology stocks. Second, it hid huge debts incurred to finance unprofitable new businesses, including retail energy services for new customers. Third, it inflated the value of other troubled businesses, including its new ventures in fiber-optic bandwidth.

With regard to hiding losses, a critical piece of the puzzle, the element that made it all work, was a derivative transaction called a price swap derivative between Enron and a special purpose entity, or SPE.

Id. Enron's management was able to deftly conceal immense losses from investors and shareholders by using complex partnership structures, thereby artificially inflating company value. *See id.*; *see also* cummings, *supra* note 8, at 1314 n.15.

314. *See supra* note 308 and accompanying text.

315. *See Enron Ex-CFO Indicted*, CNNMONEY.COM, Nov. 1, 2002 ("Andrew Fastow, the former chief financial officer of bankrupt energy trader Enron, was hit with a 78-count indictment . . . accusing him of deceiving investors by making the dying company appear financially sound."), at <http://money.cnn.com/2002/10/31/news/fastow/index.htm>; *see also* *Going After Enron Execs' Assets*, CNNMONEY.COM, Aug. 22, 2002 ("Justice Department officials say the guilty plea . . . by Michael

At least one executive, who originally pled not guilty, has since pled guilty to two counts of wire and securities fraud.³¹⁶

In order to orchestrate the intrepid and reckless deceptions perpetrated by Enron’s management, the criminally obliging officers most certainly had to feel a particular sense of protection from substantial personal risk and personal liability.³¹⁷ That craved-for protection from personal risk and liability arrived nicely packaged in 1995 in the

Kopper, a former assistant to ex-Enron Chief Financial Officer Andrew Fastow, should allow them to go after \$23 million from Fastow and other former Enron executives.”), at <http://money.cnn.com/2002/08/22/news/companies/enron/index.htm>. “Former Enron chief executive officers Jeffrey Skilling and Kenneth Lay also are under continuing investigation.” See *Enron Ex-CFO Indicted*, *supra*; see also *infra* note 308.

316. See *Enron’s Fastow Pleads Not Guilty*, USA TODAY, Nov. 7, 2002, at B1. In November 2002, one former Enron official pled “not-guilty” to a 78-count indictment “charging him with masterminding complex financial schemes that enriched him and helped doom the energy-trading powerhouse.” *Id.*; see also *Fastow and His Wife Plead Guilty*, CNNMONEY.COM, Jan. 14, 2004 (reporting that Fastow “agreed to serve a 10-year prison sentence and to cooperate with authorities”), at http://money.cnn.com/2004/01/14/news/companies/enron_fastows/index.htm.

317. See Dennis R. Fox, *The Law Says Corporations Are Persons, but Psychology Knows Better*, 14 BEHAV. SCI. & LAW 339, 339–59 (1996) (describing the risks individual corporate executives are willing to take in unethical scenarios when a sense of protection is provided by the corporate entity or when a lack of deterrent is present). Fox writes:

As detailed in Kelman and Hamilton’s (1989) analysis of “crimes of obedience,” the psychology of giving and following destructive orders and making dangerously risky decisions takes on added import within a legal framework that assigns responsibility not to real individuals but to an intangible entity. In a bureaucratically rational hierarchical institution, individuals act as agents of others rather than as independent decision makers (Coleman, 1982). Workers subordinate in the hierarchy make decisions and follow orders without absorbing responsibility for those actions. Managers and executives make decisions and follow orders—and also give them—in the name of the organization rather than in keeping with their own sense of morality. “No feelings of guilt are required, no attributions of moral blame permitted, when the stream is polluted, the baby food is diluted, or the Pinto explodes” pointed out Mitchell (1995), because “[t]he institution defines the moral role, and in the case of the corporation, the moral role is narrow indeed” (pp. 523–524). . . .

Fortunately, psycholegal scholars building on the large data base of organizational and social psychology have begun to examine decision making, risk taking, conformity, and obedience in corporate settings. Tomkins, Victor, and Adler (1992) summarized the large literature identifying “psychological realities” leading to reduced individual responsibility and dangerously risky decisions. These include diffusion of responsibility; role specialization; incomplete information; organizational culture; individual psychological defense mechanisms such as denial of injury; and, in keeping with Prilleltensky’s (1994) reminder about the importance of focusing on power, management’s ability to punish nonconformity and disobedience (see also Coleman, 1982; Hills, 1987; Kelman & Hamilton, 1989; Simon & Eitzen, 1990).

Id. at 348–49; see generally A. Mechele Dickerson, *A Behavioral Approach to Analyzing Corporate Failures*, 38 WAKE FOREST L. REV. 1 (2003).

form of the PSLRA.³¹⁸ The PSLRA carefully placed misbehaving management in a protective cocoon, mostly safe from lawsuits and liability for false forecasts and bad behavior.³¹⁹ Emboldened by these new protections, officers of dozens of corporations, enabled by their auditors,³²⁰ began to routinely misstate earnings, misrepresent value, overstate profits, and minimize or hide losses, thereby creating a fervor of illegitimate company growth and success—all of this malfeasance evidenced by the 2001 eruption of reporting company restatements of earnings forced by the SEC.³²¹

318. See *supra* sections II.A–B (describing both the removal of personal liability from management that fraudulently misrepresents as well as the removal of certain protections and safeguards for investors).

319. See *supra* sections II.A–B (describing the safe harbor affording management protection for false statements made in forecasts if accompanied by appropriate cautionary language and describing the role of the raised pleading requirements for class-action plaintiffs to bring a cause of action that would survive summary judgment).

320. See Lee & Mande, *supra* note 107, at 99–105 (detailing the significant drop in audit quality by Big Six accountants following passage of the PSLRA). While Professor Lee's study is explicit in its finding that post-PSLRA audit quality dropped dramatically, as evidenced by the sharp increase in income increasing discretionary accruals for Big Six auditors, see *id.*, some may be tempted to make the argument that the Supreme Court holding in *Central Bank* was the sole impetus behind accountants acting badly, not the PSLRA. See *supra* notes 197–204 and accompanying text. While *Central Bank* generally removed aiding and abetting liability for secondary players in securities fraud private lawsuits, the holding did ensure that accountants, lawyers and investment bankers, amongst others, could still be held to violate 10(b) and 10b-5 as primary actors, if they were substantially involved in committing the fraud. See, e.g., *In re Software Toolworks, Inc.*, 50 F.3d 615, 628 (9th Cir. 1995) (applying the substantial participation rule that has evolved in some U.S. Circuit Courts post-*Central Bank*). Thus, the PSLRA's elimination of joint and several liability, see *supra* notes 212–13 and accompanying text, together with *Central Bank's* strict limiting of aiding and abetting liability, are both behind the fraudulent behavior of Big Six auditors that enabled the corporate corruption of the late 1990s.

321. See Lerach, *supra* note 13, at 90 n.66. Quoting both Professor Coffee of Columbia Law School and Dean Seligman of Washington University School of Law, Lerach relays:

It is, of course, impossible to disentangle the intertwined causes of the latest rash of scandals. . . . But the one-sided judicial and legislative reforms of the 1990s could not have helped.

“It's very plausible that the incredible increase in corporate earnings restatements [in the late 1990s] has something to do with the liability costs for auditors going down,” says professor John Coffee, Jr., of Columbia Law School. Such restatements, which averaged 49 a year from 1990 to 1997, jumped to 91 in 1998, 150 in 1999; 156 in 2000; and more than 200 last year [2001]. “The message of the 1995 Act [PSLRA] was wrong,” says Joel Seligman, the Dean of the Washington University School of Law in St. Louis. “It was, in effect, that the basic problem with securities law was avaricious plaintiffs' lawyers. To put it simply, wise legislation requires better balance. There are also greedy corporate executives and ineffectual boards of directors, and that was lost in the 1995 analysis.”

B. El Paso

As the U.S. investing public struggled to come to grips with the Enron fiasco, El Paso, a natural gas supplier, was secretly diverting and rerouting crucial energy supplies, all in an effort to drive up the price of energy in order to bilk energy clients out of hundreds of millions of dollars, and all based on fraudulent representations in connection with the availability of energy reserves.³²² As just another example of corporate scandal in the deregulated energy industry, El Paso allegedly “illegally tightened natural gas supplies needed by California during the state’s energy crisis, contributing to a rise in power prices” as the company “withheld extremely large amounts of capacity that could have flowed to its California delivery points.”³²³ As California was mired in a dreadful energy shortage and the state scrambled to meet energy requirements, with government officials asking citizens to reduce energy usage in their homes,³²⁴ El Paso Corp. was

Id. (quoting Roger Parloff, *We Asked for It*, AM. LAW., Sept. 1, 2002, at 114); see also John R. Emshwiller & Rebecca Smith, *As Enron’s Ex-Chief Faces Trial, Focus Turns to Public Statements*, WALL ST. J., Jan. 5, 2005, at A1. Emshwiller and Smith report that:

On Oct. 23, 2001, with Enron Corp. still in the first week of the crisis that would eventually sink it, Kenneth Lay went on a public-relations offensive.

In meetings with analysts and employees, the longtime Enron chairman and chief executive touted the strength of the Houston energy giant’s operations and finances. He shrugged off growing public questions about Enron’s extensive dealings with outside partnerships run and partly owned by the company’s chief financial officer, Andrew Fastow. He predicted that Enron’s stock, then about \$19.80 a share, would soon bounce back to more than \$50. Yet by that same day, according to the U.S. government, Mr. Lay secretly had initiated efforts that within about two weeks would produce an agreement to sell the entire company to its smaller rival, Dynegy Inc., for only about \$10 a share.

Id.

322. See *El Paso Hurt Calif.: Judge*, CNNMONEY.COM, Sept. 23, 2002 (“Energy company’s shares continue to fall amid findings that it cut needed gas supplies. . . . El Paso’s shares fell another 21 cents to \$7.30 after-hours Monday following a 36 percent tumble in the regular session, as investors scrambled to size up the company’s liability for potential fines or refunds.”), at <http://money.cnn.com/2002/09/23/news/companies/elpaso/index.htm>.

323. *Id.*

324. See Nancy Vogel, *Heat Wave, Power Plant Crash Sap State’s Electricity Supplies*, L.A. TIMES, July 11, 2002, at B-1. The *L.A. Times* reported in July 2002, that during the summers of 2000 and 2001, amidst blackouts and desperate attempts to conserve, that:

“If we had had this kind of weather last summer, the lights would be off from Eureka to El Centro,” said Gov. Gray Davis, whose administration has worked to stabilize California’s electrical system after a disastrous brush with deregulation. . . .

With California largely dependant on its own energy resources, state and utility officials beseeched residents to embrace conservation as enthusiastically as they did during the electricity crisis of 2000 and 2001,

charged with intentionally misrepresenting energy availability and deliberately withholding large capacity, all in order to drive up costs and turn a larger profit.³²⁵

The State of California claimed that El Paso Corp. "overcharged by as much as \$3.3 billion for natural gas to fuel their plants because El Paso improperly capped its pipeline shipments at 79% of capacity from November 2000 to March 2001."³²⁶ El Paso, in its defense, charged that the Federal Energy Regulatory Commission administrative law judge that ruled against the company in September "wrongly micro-managed company decisions."³²⁷ El Paso claimed that rather than seeking to drive up energy costs, it merely was limiting capacity to "ensure the pipeline operated safely."³²⁸ Amidst the environment of corporate scandal and executive malfeasance, investors did not believe these protestations of El Paso, as its share price continued to spiral downward.³²⁹ Once El Paso's scheme was exposed, the

[e]nergy company's shares continue[d] to fall amid findings that it cut needed gas supplies. . . . El Paso's shares fell another 21 cents to \$7.30 after-hours Monday [Sept. 23, 2002] following a 36 percent tumble in the regular session, as investors scrambled to size up the company's liability for potential fines or refunds.³³⁰

As California struggled through a frightening energy crisis that eventually cost Governor Gray Davis his job, El Paso Corp. was charged with deliberately undercutting its energy supply pipeline to California simply to drive up energy prices and increase its bottom line by over \$3.3 billion dollars. Inexplicably capitalizing on the struggling state, El Paso allowed self-indulgence and an insatiable desire for profit and income to shroud its business judgment.³³¹ And, once

when wholesale prices soared and blackouts threatened even in low-consumption winter months.

Id. (emphasis added).

325. See *El Paso Hurt Calif.: Judge*, *supra* note 322.

326. See *FERC to Hear Case Against El Paso*, L.A. TIMES, Dec. 2, 2002, at C6. "[A] preliminary ruling against El Paso in September [2002] prompted investors to dump shares, wiping out about \$4 billion in market value and triggering downgrades of its debt. El Paso's shares dropped last week after Moody's Investors Service slashed the company's credit rating to 'junk' status." *Id.*

327. *Id.*

328. *Id.*

329. *Id.*

330. See Vogel, *supra* note 324.

331. See *Big Trouble at Ol' El Paso*, SRIMEDIA, Feb. 19, 2003 ("After a year of falling energy prices, civil lawsuits, federal investigations[,] junk debt ratings and 90% of its value wiped out, the board of El Paso Corporation is about to learn the meaning of real trouble."), at http://www.srimedia.com/artman/publish/article_392.shtml. *SriMedia* further reported that:

El Paso's future also is pending a Federal Energy Regulatory Commission ruling on whether the company withheld natural gas during California's energy crisis in 2000 and 2001. In late 2002, a judge determined

again, investors and the innocent public were struck for illnesses of the corporate purveyors of such avarice.

C. WorldCom

Just as the furor produced by the 2001 Enron debacle was dwindling, and just as congressional motivation to pass investor protective legislation was simultaneously deteriorating,³³² the WorldCom bomb dropped on the U.S. capital markets.³³³ The WorldCom calamity

El Paso, which controlled about 20% of the natural gas supply to California had used its position to raise power prices.

Id.; see also *Fraud Allegedly Plagues Energy Trading*, AP, Dec. 5, 2004 (“Before 2003, energy trading had little oversight and room for abuse. A slew of indictments handed up a week ago illustrate those days aren’t just a memory.”), available at http://www.pulpony.org/html/fraud_allegedly_plagues_energy.html. The AP reported in December 2004 that:

Five former traders from three Houston-based companies—El Paso Corp., Reliant Energy Inc. and Dynegy Inc.—were indicted on charges of reporting fake trades to industry publication that use such information to calculate index prices of natural gas. Movement in such prices can affect traders’ profits. . . . “Because there were no rules, people did what they wanted,” [Federal Energy Regulatory Commission Chief Andrea] Wolfman said. “It was a little like the wild west.”

Id.

332. See Stephen Labaton & Richard A. Oppel, Jr., *Enthusiasm Waning in Congress for Tougher Post-Enron Controls*, N.Y. TIMES, June 10, 2002, at A1 (“Six months after the collapse of Enron, a wave of enthusiasm for overhauling the nation’s corporate and accounting laws has ebbed and the toughest proposals for change are all but dead.”). The N.Y. Times reported that an influential group of lobbyists, using partisan differences in Congress as its apparatus, had nearly killed Congressional efforts to “impose tight new controls on corporate conduct.” See *id.* (“Bills imposing more stringent accounting standards, changing the tax and accounting treatment of employee stock options and setting tougher conflict-of-interest rules for stock analysts and accounting firms have all fallen victim to political gridlock.”); see also cummings, *supra* note 8, at 1316 n.19.
333. See David Saito-Chung & Jonah Keri, *Stocks Undercut Lows on WorldCom Worries, But Recover at Close Ho-Hum to Latest Frauds? Harldy—Investor’s Faith Seems Shaken: President Pledges To Go After Crooks*, INVESTOR’S BUS. DAILY, June 27, 2002, at A1 (“WorldCom’s admission of financial wrongdoing rocked the stock market Wednesday [June 26, 2002] and left investors wondering how and when the epidemic of sickly accounting will be cured.”); see also Francine Knowles, *Faith in Corporate America Crumbles*, CHI. SUN-TIMES, June 27, 2002, at 6; Kevin Maney, *WorldCom CFO Driven to Win: Once Respected, Scott Sullivan Is Now at the Center of Controversy*, CHI. SUN-TIMES, Aug. 27, 2002, at 39 (“WorldCom fired [CFO Scott] Sullivan in late June after the accounting misdeeds were unearthed.”).

spurred Congress into action³³⁴ and seemingly moments later³³⁵ Congress passed the Sarbanes–Oxley Act with much fanfare.³³⁶

If the securities industry and investing public were stunned at the size and scope of the deceptions that Enron's management had perpetuated, they were absolutely confounded by the range and depth of the corruption exhibited by WorldCom's management.³³⁷ In an eerily familiar scene, evocative of Enron's congressional hearings, some of WorldCom's senior officers, when called upon to testify before the U.S. House of Representatives Financial Services Committee in early July 2002, refused to testify.³³⁸ Members of the House Financial Services Committee were "outrage[d]" at the deliberate silence exhibited by top WorldCom management called to Washington, D.C. to account for management inaction in light of WorldCom's colossal collapse.³³⁹ The House Committee members were stonewalled in their efforts to get to the bottom of the scandal that bankrupted the nation's second largest long-distance telephone provider.³⁴⁰

When WorldCom began to buckle under the weight of its own distortion, most commentators predicted that the company would be

334. See Tom Hamburger et al., *WorldCom Scandal Spurs Congress*, WALL ST. J., June 27, 2002, at A8 (indicating that Congress may have been spurred to action based on the WorldCom scandal, after the reform furor had died down over Enron). "The giant WorldCom accounting scandal is giving a powerful boost of energy to the drive in Congress to clean up business practices, accelerating legislation reining in the accounting industry and shooting new life into a range of other corporate-reform proposals." *Id.*

335. Enron-motivated congressional reform of the securities industry was as good as dead in early June 2002, *supra* note 332, until the news of WorldCom's implosion dropped on June 26, 2002, *supra* note 333. A newly inspired (and traumatized) Congress moved at hyperspeed to pass the Sarbanes–Oxley Act, *infra* note 376, which was signed by the once-reluctant President George W. Bush on July 25, 2002. See Cummings et al., *supra* note 26, at A1; see also Molly Ivins, *Sarbanes Bill Fixes Only One Horror*, CHARLESTON GAZETTE, Aug. 3, 2002, at 4A ("Let's review what we got with the Sarbanes Bill, so proudly declared by President Bush (who opposed the entire package until two weeks ago) to be 'the most far-reaching reform of American business practices since the time of Franklin Delano Roosevelt.'"); Statement on Signing the Sarbanes–Oxley Act of 2002, 38 WEEKLY COMP. PRES. DOC. 1271, 1286 (July 30, 2002).

336. See Part V.

337. See Jared Sandberg et al., *Disconnected: Inside WorldCom's Unearthing of a Vast Accounting Scandal*, WALL ST. J., June 27, 2002, at A1 (carefully detailing the unorthodox secreting of expenses as capital expenditures by WorldCom's Chief Financial Officer, Scott Sullivan, in effect misstating over "\$3.8 billion of expenses that were improperly booked and [would have to] be restated"). WorldCom Inc. duped investors for over fifteen months claiming large profit margins when in fact the company was hemorrhaging money steadily. See *id.*

338. See Jake Ulick, *WorldCom Blames Auditor*, CNNMONEY.COM, July 8, 2002, at <http://money.cnn.com/2002/07/08/news/companies/worldcom/index.htm>.

339. *Id.*

340. See *id.*

forced to declare bankruptcy.³⁴¹ Those pundits did not have to wait long³⁴² to be proven right, as WorldCom soon thereafter filed a bankruptcy petition larger than any ever filed in U.S. history,³⁴³ making it the largest corporate failing of its kind and leading to serious problems for the “nation’s long-distance phone industry.”³⁴⁴ Adding to the depth of WorldCom’s deceit and to the further astonishment of the investing public and securities industry, was that on at least two occasions since it was initially exposed as fraudulent, the company has been forced to restate its loss projections, which were originally reported at \$3.8 billion, but now exceed \$11 billion.³⁴⁵ To this day, deeper layers of fraud continue to be exposed.³⁴⁶

341. See Reinhardt Krause, *WorldCom Collapse Is Likely To Force a Rethinking of U.S. Telecom Policies: Others To Feel Squeeze Too*, INVESTOR’S. BUS. DAILY, June 27, 2002, at A1 (“The No. 2 long-distance firm, WorldCom is near bankruptcy. It disclosed a multibillion-dollar accounting fraud . . . sending shock waves through an already sick industry.”).

342. WorldCom revealed “on June 25, 2002, that it had committed the largest fraud in history.” Christopher Stern, *King of the Bad-News Bulls*, WASH. POST., Oct. 10, 2003, at E1. Less than one month later, on July 22, 2002, the company declared bankruptcy. See Simon Romero & Riva D. Atlas, *WorldCom’s Collapse: The Overview*, N.Y. TIMES, July 22, 2002, at A1 (detailing WorldCom’s Chapter 11 bankruptcy filing), available at <http://www.nytimes.com/2002/07/22/business/22CND-TELE.html>.

343. See Romero & Atlas, *supra* note 342.

344. See Krause, *supra* note 341, at A1.

345. See Stern, *supra* note 342 (“In its initial account to the Securities and Exchange Commission, WorldCom said that it had uncovered about \$3.8 billion in improper booking. But that turned out to be just the beginning of a series of announcements, with the final tally on the company’s fraud closer to \$11 billion.”); see also Jeremy Pelofsky & Dane Hamilton, *WorldCom to Pay \$500 Million to Settle SEC Charges*, YAHOO NEWS, May 21, 2003 (“WorldCom Inc. agreed on Monday [May 19, 2003] to pay a record \$500 million fine to settle charges stemming from one of the biggest accounting fraud cases in U.S. history. Under the tentative deal reached between WorldCom and the Securities and Exchange Commission, the No. 2 U.S. long-distance telephone and data services company would pay the penalty and the funds would then be doled out to victims of the roughly \$11 billion accounting fraud.”), at <http://in.tech.yahoo.com/030521/137/24hef.html>.

346. See *supra* note 87 and accompanying text. On March 15, 2005, Bernard Ebbers, former CEO of WorldCom, was convicted by a jury of “orchestrating the \$11 billion fraud that sank the company in 2002, the biggest corporate fraud and bankruptcy in U.S. history.” Erin McClam, *Conviction at Trial Marks Stunning Fall for Ebbers*, TUSCALOOSA NEWS, Mar. 16, 2005, at 1A. “As a jury forewoman read the verdict—guilty on all nine counts, including fraud and conspiracy—Ebbers face reddened noticeably.” *Id.* McClam reports:

They called him the Telecom Cowboy, a darling of Wall Street who took a small long-distance company global by steering a snowballing set of mergers and acquisitions.

Now, Bernard Ebbers is the government’s biggest catch since it began pursuing the largest corporate fraudsters three years ago. He could spend the rest of his life in federal prison. . . .

. . . .

WorldCom management, secure in the knowledge that the PSLRA had provided necessary liability insulation, deliberately misstated earnings projections and purportedly hid expenses and losses.³⁴⁷ Due in large part to the Telecommunications Act deregulations, WorldCom existed and perpetrated these falsehoods in a more secluded environment, safe from federal government oversight and outside any federal control.³⁴⁸

D. Adelphia

With the WorldCom telecommunications squalor still thickly in the air, Adelphia's sins dropped on an unsuspecting, but increasingly cynical, investing public.³⁴⁹

The conviction comes more than two years after an internal auditor began asking questions about curious accounting at WorldCom, touching off a scandal that eventually unearthed \$11 billion in cooked books.

....
The company struck a \$750 million settlement with federal regulators to repay the aggrieved investors, a small sum compared to the tens of billions of dollars of market capitalization that evaporated in the scandal.

Id. at 1A, 7A.; see also Almar Latour et al., *Ebbers is Convicted in Massive Fraud: WorldCom Jurors Say CEO Had to Have Known; Unconvinced by CFO*, WALL ST. J., Mar. 16, 2005, at A1 ("After eight days of deliberation, the jury found Mr. Ebbers guilty of all nine counts against him, including conspiracy and securities fraud, related to the accounting fraud that topped \$11 billion."); Jesse Drucker & Li Yuan, *Documents May Have Been Decisive in Convicting Ebbers*, WALL ST. J., Mar. 17, 2005, at C1 ("In the Bernard Ebbers trial, the decisive evidence may not have been the star witnesses on either side. It may have been the hundreds of pieces of paper and other exhibits the jurors pored through during the eight days of deliberation."). The *Wall Street Journal* reported that the jury was convinced by the financial documents that they analyzed prior to reaching the guilty verdict:

For Salina Strong, juror No. 4, the jury's task was to read as many documents as necessary to corroborate what they were hearing in the courtroom.

The result: numerous requests for reams of exhibits, including monthly financial reports, press releases and even videotapes of Mr. Ebbers's speeches and television interviews.

Like many other jurors in the case in federal court in New York City, she said she didn't find "credible" the testimony of Mr. Sullivan [former WorldCom CFO], the star prosecution witness. Instead, certain financial reports that were sent to Mr. Ebbers's office were more important—so the jury asked to see them themselves. "You saw those adjustments" in the reports, she recalled. "if we could see them, how could he not see them?"

Id.

347. See Pelofsky & Hamilton, *supra* note 345.

348. See Cummings, *supra* note 31; see generally Lee & Mande, *supra* note 107.

349. See Claudia H. Deutsch & Joseph B. Treaster, *Corporate Conduct: The Reaction; Other Executives Voice Satisfaction at Arrests*, N.Y. TIMES, July 25, 2002, at C5 (describing the arrest of former Adelphia executives for fraud).

In yet another example of corporate fraud and criminal activity by the management of a major U.S. [telecommunications] corporation, former executives of Adelphia . . . were arrested July 10, 2002:

Three members of the founding family of troubled cable operator Adelphia Communications Corp. and two former executives were arrested on Wednesday on federal securities and bank fraud charges.

The complaint, unsealed in Manhattan federal court, names as defendants former Chief Executive John Rigas; former Chief Financial Officer Timothy Rigas; Michael Rigas, former executive vice president, operations; James R. Brown, former vice president, finance; and Michael Mulcahey. . . .

The lengthy complaint alleges the defendants conspired to commit securities, wire, and bank fraud. “The investigation has revealed probable cause to believe that John J. Rigas . . . together with members of his family has looted Adelphia on a massive scale, using the company as the Rigas family’s personal piggy bank at the expense of public investors and creditors,” the complaint alleges.

The Rigas family members had resigned from Adelphia following the disclosure of billions of dollars of off-balance-sheet loans guaranteed by the company to the Rigas family personally, overstated earnings, and other accounting issues.³⁵⁰

In November 2002, James R. Brown, Adelphia’s former executive vice-president, pled guilty to bank fraud and other charges “as part of a [plea] deal to testify against Rigas family members accused of plundering the now-bankrupt cable company.”³⁵¹

As Adelphia sought bankruptcy protection due to Rigas management malfeasance, the bankrupt cable operator announced the appointment of a new chairman whom the company hoped would lead it back to solvency and respectability as a viable corporate concern.³⁵² While Adelphia appears to be emerging as a viable corporate concern, the staggering breadth of corporate fraud perpetrated by Adelphia management upon the U.S. investing public continues to bewilder. Again, the Rigas family, emboldened by the opportunity to be insulated from risk and liability through the PSLRA, and then given free-

350. cummings, *supra* note 8, at 1380 n.344 (quoting *Former Adelphia Executives Arrested for Fraud*, N.Y. TIMES, July 24, 2002).

351. See Devlin Barrett, *Former Adelphia Exec Cuts Plea Deal*, CBSNEWS.COM, Nov. 14, 2002 (“The former vice president of finance at Adelphia Communications Corp. was the first person to plead guilty in the scandal that authorities say cost investors more than \$60 billion.”), at <http://www.cbsnews.com/stories/2002/06/26/national/main513444.shtml>.

352. See *Adelphia Names New Chiefs: Bankrupt Cable Company Seeks Help from 2 Top AT&T Broadband Executives*, CNNMONEY.COM, Jan. 17, 2003 (“Bankrupt cable operator Adelphia Communications Corp. . . . named former AT&T executive William Schleyer as its chairman and chief executive In addition, the company said Ron Cooper, AT&T Broadband’s chief operating officer, would be appointed with the same title at Adelphia.”), at <http://money.cnn.com/2003/01/17/news/companies/adelphia/index.htm>; see also Peter Grant, *Cable Giants’ Adelphia Purchase Could Change Industry Picture*, WALL ST. J., Apr. 11, 2005, at B2 (detailing likely acquisition of Adelphia by Time Warner, Inc.).

dom to roam with less federal oversight by the Telecommunications Act, went off on a spending, cheating, deceiving, unethical, and dishonorable extravaganza of recklessness.³⁵³

E. Global Crossing

Stunned by Enron and not yet blindsided by WorldCom, U.S. investors and the securities industry were cuffed by Global Crossing when news of its transgressions hit the airwaves, described as the "latest killer earthquake rumbling on Wall Street."³⁵⁴ Global Crossing, launched in 1997 by founder and former junk-bond trader Gary Winnick,³⁵⁵ rapidly built a preeminent "worldwide fiber-optic communications network."³⁵⁶ Global Crossing's dramatic collapse and subsequent bankruptcy filing in January 2002 made it the fourth-largest public bankruptcy in U.S. history.³⁵⁷ Global Crossing's downfall was precipitated "by the entrance of a flurry of competitors and a sharp drop in demand for broadband capacity" that made it impossible for it to pay off its massive debt.³⁵⁸ Despite the flurry of competition and the drop in demand for broadband capacity, the primary reason for Global Crossing's crushing failure was the misrepresentation and outright fraud perpetrated by Winnick and Global Crossing's executive management.³⁵⁹

Global Crossing's primary accounting trick to inflate value, increase revenue, and deceive shareholders and employees was its "now-infamous asset swaps it conducted with other telecom companies."³⁶⁰ Essentially Global Crossing inflated its financial status by selling broadband capacity on its network to other telecommunications carriers and recording such sales as revenue while concurrently buying

353. See *supra* notes 349–52 and accompanying text.

354. Adam Lashinsky, *Being Global Crossed: Investors in Other Telecoms Are Likely To Suffer Fall-Out from the Demise of Global Crossing*, CNNMONEY.COM, Feb. 13, 2003, at <http://money.cnn.com/2002/02/13/investing/lashinsky/index.htm>.

355. See Mark Harrington, *Global Crossing Files Chapter 11*, NEWSDAY, Jan. 29, 2002, at A43.

356. Edward S. Adams, *Corporate Governance After Enron and Global Crossing: Comparative Lessons for Cross-National Improvement*, 78 IND. L.J. 723, 777 (2003). Adams writes:

In contrast to Enron, Global Crossing's problems appear to have their beginnings in its board of directors. Winnick was firmly rooted in Global's board as its chairman. In stark contrast, the rest of the board had been composed of thirty different directors since 1998, with the board's size ranging between eight and seventeen members during that time.

Id.

357. See *Global Crossing Director Resigns, Third in Month*, REUTERS ENGLISH NEWS SERV., Mar. 4, 2002.

358. Adams, *supra* note 356, at 777.

359. See *id.* at 777–78.

360. Lashinsky, *supra* note 354.

back a like amount of capacity on other telecommunications carriers and recording such buybacks as non-liabilities.³⁶¹ While Global Crossing and other telecommunications carriers maintained their innocence by conveniently blaming their accountants for reporting irregularities,³⁶² such cries of innocence are belied by Global Crossing executives’ behavior leading up to and directly following its bankruptcy filing.³⁶³ In January 2002, when Global Crossing filed for Chapter 11 bankruptcy protection:

Global Crossing failed to provide severance pay to thousands of laid-off employees after filing for bankruptcy protection, but a published report Thursday [Feb. 21, 2002] said the outcome for many company executives was quite different, with some receiving millions of dollars in pensions and loan forgiveness. . . .

The Bermuda-based company also moved up its last pay date by a week so its executives and other still-employed staff could be paid before the company declared bankruptcy Jan. 28. . . .

Global Crossing also forgave large loans to executives, including one for \$10 million to Legere. In addition, Global Crossing has made 11th-hour lump-sum pension payouts totaling \$15 million to high-ranking executives in recent months, most of them no longer employed by the company.³⁶⁴

Global Crossing engaged in an elaborate shell game with U.S. investors and its employees. Emboldened by the PSLRA and freed from federal oversight by the Telecommunications Act, Global Crossing fleeced investors of billions of dollars of value and crushed once-loyal employees.³⁶⁵

361. See *Global Crossing Restates Financials*, CNNMONEY.COM, Oct. 21, 2002 (“Bankrupt telecommunications service provider Global Crossing Monday [Oct. 21, 2002] said it will restate some of its recent financial statements to reflect ‘swap deals’ it made with other providers, erasing some \$19 million in revenue.”), at <http://money.cnn.com/2002/10/21/technology/global/index.htm>.

362. See *id.* In connection with Global Crossing’s capacity swap agreements and financial restatements recorded in response to such, *CNN Money* reports:

The company [Global Crossing] said it made the restatement to reflect swaps deals it made during the period. The Securities and Exchange Commission recently had deemed such transactions improper. Global Crossing blamed beleaguered auditing firm Arthur Andersen for the discrepancy, saying the firm advised it to account for the transactions is [sic] such a way. It said the SEC has told the company that such accounting did not comply with Generally Accepted Accounting Principles, or GAAP.

Id.; see also Lee & Mande, *supra* note 107, at 93–105.

363. See *Global Crossing Shielded Execs: Firm Reportedly Moved Up Pay Date, Gave Executives Big Pensions*, CNNMONEY.COM, Feb. 21, 2002, at <http://money.cnn.com/2002/02/21/technology/globalcrossing/index.htm>.

364. *Id.* “The Wall Street Journal report indicated that that [sic] even though the telecommunications company has never turned a profit, in October [2001] it awarded its new CEO, John Legere, a \$3.5 million signing bonus despite the fact that he already was employed in a separate Global Crossing affiliate in Asia.” *Id.*

365. See *cummings*, *supra* note 31.

F. Qwest

Qwest, like its telecommunications rivals WorldCom and Global Crossing, engaged in deceptive accounting practices while pursuing the all-important corporate value and revenue.³⁶⁶ Of its most serious deceptions in its quest for value and revenue, illegal swap agreements top the list of Qwest indiscretions.³⁶⁷ Qwest engaged in swaps of telephone connections with other telecommunications carriers and recorded the swaps as new revenue.³⁶⁸ Such swaps, coupled with other dubious accounting practices, caused Qwest to have to restate all of its misrepresented value.³⁶⁹ Qwest ended up restating more than \$2.2 billion in value and four of its executives were indicted for artificially inflating Qwest's revenue.³⁷⁰

While maintaining that its dubious swap agreements were arguably permissible, Qwest executives engaged in further unsavory and familiar practices when the news dropped that it would be restating financial disclosures.³⁷¹ On March 13, 2002:

Qwest Communications International Inc. joined the ranks of troubled companies Enron and Global Crossing when it prohibited thousands of employees from selling company stock or other assets in 401(k) plans over a four-week period in December and January. . . . Although Qwest shares only fell 7 percent during the four weeks, it's reminiscent of the move made by Enron when it prohibited employees from selling stock and 401(k) assets as it headed toward bankruptcy.³⁷²

Taking advantage of the deregulated telecommunications environment, Qwest, and a battery of other corporate malefactors, engaged in deceptive and dishonest practices to inflate value artificially and to ultimately reap ill-gained rewards from a duped investing public.³⁷³

366. See Jerry W. Markham, *Accountants Make Miserable Policemen: Rethinking the Federal Securities Laws*, 28 N.C. J. INT'L L. & COM. REG. 725, 781-82 (2003).

367. See *id.* at 782.

368. See Dennis K. Berman et al., *Tricks of the Trade, As Market Bubble Nears End, Bogus Swaps Provided a Lift*, WALL ST. J., Dec. 23, 2002, at A1.

369. See *id.*

370. See Dennis Berman & Deborah Solomon, *Ex-Executives Are Indicted in Qwest Probe*, WALL ST. J., Feb. 26, 2003, at B1.

371. See *Qwest Locked Down 401(k)'s: Troubles Telecom Barred Employee Stock and Asset Sales for 4-Week Period*, CNNMONEY.COM, Mar. 13, 2002, at <http://money.cnn.com/2002/03/13/technology/qwest/index.htm>.

372. *Id.* "In addition to the job cuts and debt reviews, Qwest said Monday the Securities and Exchange Commission is investigating methods the company used to book sales in 2000 and 2001." *Id.*

373. See Deborah Solomon & Dennis K. Berman, *Qwest's Nacchio to Face SEC Charges*, WALL ST. J., Mar. 11, 2005, at A3 ("Securities regulators plan to file civil charges as early as next week against Joseph P. Nacchio, the former chief executive of Qwest Communications International Inc., over his role in accounting fraud at the Denver telecommunications company, according to people familiar with the matter."). Solomon and Berman report that:

In a long-awaited action, the Securities and Exchange Commission also is expected to file charges against about a dozen other former Qwest

Simply stated, it is difficult to claim coincidence when examining the bulk of the major corporate criminals responsible for the crash of 2002. Most major malfeasors are corporations in industries deregulated by the Revolution Congress.³⁷⁴ Most, if not all, major malfeasors are corporations that employed (and criminally collaborated with) Big Six auditing firms, whose accountants were found to have significantly decreased audit quality and ballooned income increasing discretionary accruals following the deregulatory and reform hysteria of the PSLRA and *Central Bank*.³⁷⁵ Deregulation on a national scale has badly failed, was ill-conceived, and has been responsible in large part for the failing market and sick economy of 2001, 2002, and 2003.

In a typical rush to legislate, the 107th Congress, still teeming with hundreds of holdovers from the Republican Revolution and devotees of the arguably failed “Contract with America,” passed the toothless and too-weak Sarbanes–Oxley Act in startlingly rapid fashion.

V. DID THE SARBANES–OXLEY ACT RECAPTURE ANY LOST PROTECTIONS?

The question—whether the Sarbanes–Oxley Act of 2002³⁷⁶ recaptured any lost protections or federal regulations given away in the PSLRA, the Telecommunications Act, or the CFMA—must be answered with an emphatic no.³⁷⁷ The primary disconnect, overlooked by most commentators and apparently by the members of the 107th Congress, is that deregulation and the PSLRA, the Telecommunications Act, and the CFMA must shoulder a large portion of the blame for the historic stock market collapse of 2001–02.³⁷⁸ Yet the protections, which were discarded by the Revolution Congress when it enacted the deregulatory legislation, have not been returned to the U.S.

executives, including two chief financial officers and a chief operating officer. While exact charges aren’t known, the SEC’s case is expected to accuse the former executives of a program to falsely represent the company’s financial condition, particularly Qwest’s ability to meet aggressive revenue goals during the telecommunications investing boom of the late 1990s.

Id.

374. See Cummings et al., *supra* note 26, at A1 (“[T]he most notorious [fraud-plagued corporations] have exploded in sectors deregulated in the 1990s . . .”).

375. See Lee & Mande, *supra* note 107, at 99–105; see also *supra* notes 108–10, 305, 320 and accompanying text.

376. See 15 U.S.C.A. §§ 7201–7266 (West Supp. 2004); Sarbanes–Oxley Act of 2002, Pub. L. 107-204, 115 Stat. 745.

377. See *infra* notes 378–401 and accompanying text.

378. See Cummings, *supra* note 8, at 1307 n.4 (detailing the collapse of the U.S. capital markets in 2001 and 2002 and styling it the “Crash of 2002”).

investing public; nor have they been addressed or restored by the Sarbanes–Oxley Act (or “SOX”).³⁷⁹

While the 107th Congress had a tremendous opportunity to reject the “super heightened” pleading standard instituted by the PSLRA,³⁸⁰ to remove the dangerous corporate-executive protections for forward-looking statements originated in the PSLRA,³⁸¹ and to discard the nearly impossible aider-and-abettor standard articulated in *Central Bank*,³⁸² it badly failed to correct these errors.³⁸³ While the 107th Congress had an excellent opportunity to reexamine its deregulatory mistakes perpetrated in the Telecommunications Act, particularly noting in hindsight that the 105th Congress had miscalculated badly many of its assumptions in connection with growth and expectation in the telecom industry, the 107th Congress did nothing to re-regulate the telecom industry and correct its mistakes through remedial legislation.³⁸⁴ Finally, with a chance to redeem itself for abruptly and wrongly enacting the CFMA, the 107th and 108th Congresses have failed to regulate fully an industry in desperate need of federal oversight—commodity derivatives trading, particularly in energy and electricity.³⁸⁵

In truth, SOX, which has been criticized as doing little more than attempting to assuage the conscience of U.S. investors, has accomplished little or nothing where investor protections are concerned.³⁸⁶

379. See Lerach, *supra* note 13, at 123 (“Unfortunately, [the] Sarbanes–Oxley [Act] did not undo a single provision of the 1995 [PSLRA]”).

380. See *supra* note 135.

381. See *supra* notes 172–73.

382. See *supra* notes 197–204.

383. See *supra* note 379.

384. See generally, Michael A. Hiltzik and James E. Peltz, *Did Telecom Reformers Dial the Wrong Number?; Deregulation: A 1996 Landmark Law May Be at the Root of the Industry's Meltdown Analysts Say*, L.A. TIMES, July 24, 2002, at 1-1 (“As the wreckage of once-highflying telecommunications companies such as WorldCom Inc. and Global Crossing Ltd. piles up, attention is turning to whether the root of the disaster lies in the sweeping deregulation set in motion in the mid-1990s that was expected to usher in a golden age of competition.”); see also cummings, *supra* note 31.

385. See *supra* notes 289–303 and accompanying text.

386. See ROBERTA ROMANO, N.Y. UNIV. SCH. OF LAW, NEW YORK UNIVERSITY LAW AND ECONOMICS WORKING PAPERS, No. 3, THE SARBANES–OXLEY ACT AND THE MAKING OF QUACK CORPORATE GOVERNANCE 1 (2004) (“The learning of the literature, which was available when Congress was legislating, is that SOX’s corporate governance provisions were ill-conceived. . . . SOX was enacted as emergency legislation amidst a free-falling stock market and media frenzy over corporate scandals shortly before the midterm congressional elections.”), available at <http://lsr.nellco.org/nyu/lewp/papers/3>; see also Lerach, *supra* note 13, at 122–23. Lerach describes the potential effectiveness of the Sarbanes–Oxley Act as follows:

This new law [Sarbanes–Oxley] does precious little to empower investors. It increases prison terms—but violation of the securities laws has long been a felony carrying long prison terms due to the provisions of the

Certainly, the Sarbanes–Oxley Act has done nothing to address the deficiencies created by the PSLRA. Nor has SOX done anything to remedy the deregulatory chaos that emerged through enactment of the Telecommunications Act. Neither has the Sarbanes–Oxley Act sought to offer new regulation in the energy or derivatives trading industries. Simply, SOX does not address, in any sense, the failed deregulations perpetrated by the Revolution Congress. Congress’s bid once again to offer protection to investors and ensure the integrity of the U.S. capital markets will not come about via Sarbanes–Oxley.

The Sarbanes–Oxley Act, formally the “Public Company Accounting Reform and Investor Protection Act of 2002,”³⁸⁷ was enacted by the 107th Congress in nearly unanimous fashion.³⁸⁸ SOX, while hastily drawn together and passed with little legislative history, proposes to “override[] and significantly modify both the pre-existing structure for the regulation of the accounting profession and much traditional corporate governance that was formerly the exclusive subject of state law.”³⁸⁹ While it appears unlikely that SOX will have any significant effect on improving investor protection, on ensuring capital market integrity, or even on encouraging appropriate behavior from corporate executives, the Act certainly busies itself with window dressing.³⁹⁰

sentencing guidelines. . . . It increases the authority of the SEC—but the SEC helped get us in the mess in the first place. The real problem at the SEC is the pro-corporate bias of its recent Chairmen—not a lack of statutory authority or power. It establishes yet another new accounting oversight board—but these kinds of oversight entities have existed for years, have always been coopted by the accounting industry and were in place when the accounting excesses that got us where we are now were put in place and pursued. Yes it gives investors a short extension of the statute of limitations, but the litigation playing field is not tilted by the time period within which a victim must sue, but rather by a punitive pleading standard, the lack of aiding-and-abetting liability, the lack of joint-and-several liability, a harsh sanctions provision, a safe harbor permitting executives to knowingly lie about financial projection and forcing all securities call action suits into federal court, depriving investors of their traditional remedies under state law.

Id.

387. Sarbanes–Oxley Act of 2002, Pub. L. 107-204, 115 Stat. 745.

388. See John C. Coffee, Jr., *An Introduction to the Sarbanes–Oxley Act*, in RICHARD JENNINGS ET AL., *SARBANES–OXLEY ACT SPECIAL SUPPLEMENT: FEDERAL SECURITIES LAW: SELECTED STATUTES, RULES AND FORMS* 1 n.1 (2003) (“The Act (107 Pub. L. No. 204, 116 Stat. 745) passed the Senate 99–0 and the House 423–3.”).

389. *Id.*

390. Of note, while SOX added little by way of investor protection, the New York Stock Exchange did adopt new listing standards and implemented requirements mandating that NYSE member corporations incorporate “an internal audit function and adopt and publish a code of business conduct and ethics.” Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 488 (2003) (citing Press Release, New York Stock Exchange, NYSE Approves Measures to Strengthen Corporate Accountability (Aug. 1, 2002), available at <http://www.nyse.com/press/NT00545421.html>). While a short

- (1) Title I of the Sarbanes–Oxley Act creates a self-regulatory body, the “Public Company Accounting Oversight Board,” to regulate the accounting profession by establishing auditing standards and imposing discipline.³⁹¹
- (2) Section 301 of the Sarbanes–Oxley Act mandates that a public company’s audit committee must be composed exclusively of independent directors and seeks to strengthen the powers and responsibilities of the audit committee.³⁹²
- (3) Section 307 of the Sarbanes–Oxley Act directs the SEC to “promulgate rules of practice that require attorneys appearing before it to report ‘evidence’ of material securities law violations, fiduciary breaches, or similar misconduct” involving an attorney’s public reporting of the client “first, to its chief legal counsel or CEO and then, if those officers fail to act ‘appropriately,’ up the ladder to the company’s audit committee, its independent directors, or its board of directors as a whole.”³⁹³

examination of the Sarbanes–Oxley Act is undertaken here, a full and exhaustive examination of that legislation is beyond the scope of this Article.

391. See Coffee, *supra* note 388, at 2. Professor Coffee writes that:

The centerpiece of the [Sarbanes–Oxley] Act is the Public Company Accounting Oversight Board (the “Board”), which is empowered and instructed to “oversee the audit of public companies that are subject to the securities laws, and related matters, in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports. . . .” Although the Board is a private body, established as a non-profit corporation, the Act expressly makes it subject to SEC oversight in a manner paralleling the relationship between the SEC and the NASD. The five members of the Board are appointed by the SEC (after consultation with the Chairman of the Board of Governors of the Federal Reserve System and the Secretary of the Treasury) for five-year terms. Two (but only two) of the Board’s five members must be certified public accountants. These restrictions are obviously intended to prevent the “capture” of the Board by the accounting profession.

Id. at 3. (footnotes omitted).

392. *Id.* at 2.

393. *Id.* Professor Coffee reports in connection with the attorney reporting responsibility provision:

In one of its more controversial provisions (which was added by a floor amendment submitted by Senator Edwards of North Carolina), Section 307 of the Act requires the SEC to prescribe “minimum standards of professional conduct for attorneys” who practice before the SEC. These rules must require attorneys who represent public companies “to report evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof” to the company’s chief legal counsel or CEO. If those officers do not take appropriate action, Section 307 further mandates that the SEC’s rules require the attorney to report the evidence to the public company’s audit committee, to its independent directors, or to the board of directors as a whole.

- (4) Sections 302 and 906 of the Sarbanes–Oxley Act require the CEOs and the CFOs of public reporting companies to provide on an ongoing and continuous basis a prescribed certification of their company’s financial statements and imposes an enhanced criminal sanction for certifications that are knowingly false.³⁹⁴
- (5) Title IV of the Sarbanes–Oxley Act requires reporting companies to make more current, real-time disclosures of material changes in the company’s financial condition.³⁹⁵
- (6) Section 403 of the Sarbanes–Oxley Act obligates directors, principal stockholders, and officers of a company to disclose transactions in their company’s securities within two business days.³⁹⁶
- (7) Section 501 of the Sarbanes–Oxley Act instructs the SEC to promulgate rules governing the objectivity and independence of securities analysts and rules protecting analysts from retaliation from their firms because of negative research or ratings.³⁹⁷
- (8) Section 201 of the Sarbanes–Oxley Act prohibits an accounting firm, that audits a reporting company, from conducting contemporaneous nonaudit services for that same reporting company, in nine categories.³⁹⁸

The Act also empowers the SEC to censure, suspend, or deny any person the privilege of appearing or practicing before the SEC (temporarily or permanently) if that person is found to not possess the “requisite qualifications to represent others,” to be “lacking in character or integrity, or to have engaged in unethical or improper professional conduct,” or to have willfully violated or aided and abetted a violation of the securities laws or the rules and regulations thereunder.

Id. at 11–12 (footnotes omitted).

394. *Id.* at 2.

395. *Id.*

396. *Id.*

397. *Id.* “[T]his provision was obviously prompted by recent disclosures involving Merrill Lynch, Salomon Smith Barney, and Credit Suisse First Boston, which appeared to show their analysts contradicting published recommendations or ratings in contemporaneous internal emails.” *Id.*

398. *Id.* In relation to the prohibitions imposed upon accounting firms, Professor Coffee maintains:

Section 201 contains the Act’s most controversial provision regarding accounting, which prohibits accounting firms from providing a variety of non-audit services contemporaneously with auditing of any public company. The services specifically prohibited by the Act are the following:

- (1) bookkeeping or other services related to accounting records or financial statements of the audit client;
- (2) financial information systems design and implementation;
- (3) appraisal or valuation services, fairness opinions, or contribution-in-kind reports;
- (4) actuarial services;
- (5) internal auditing outsourcing services;

While not exhaustive, the preceding list of SOX provisions shows clearly that Congress sought to get at the problem of corporate malfeasance through singular and fairly limited, timid efforts.³⁹⁹ Sadly, nowhere in the Sarbanes–Oxley Act can an effort to re-regulate the 1990s deregulated industries be found—which most assuredly must be one important answer to the spate of recent corporate criminality.

One Sarbanes–Oxley area that can be viewed as a small victory for investor protection and its advocates is the section that increases the statute of limitations for initiating investor securities actions against an allegedly bad-acting corporation from one year to two years.⁴⁰⁰ While the statute of limitations increase is a small part of SOX, it is important in that Congressional support was sought and eventually won for protection of U.S. investors. Unfortunately, this small victory is almost completely negated by the fact that the Sarbanes–Oxley Act did not correct, nor endeavor to correct, the impossibly high pleading standard for plaintiffs promulgated by the PSLRA.⁴⁰¹

VI. PROPOSALS FOR RE-REGULATION

Certainly, the picture of malfeasance painted above is bleak and gloomy. Undoubtedly, the “deregulators” of the Revolution Congress believed that the corporate executives and industry insiders would behave in a fundamentally fair and honest fashion when given the reins to the most deregulated modern economy and industry in U.S. history. Unfortunately, for the Contract with America deregulators, massive fraud, mindboggling dishonesty, and economic disaster were the rewards for hastily passing and joyously deregulating crucial U.S. industries. Federal regulation must be returned in several sectors and industries in order to once again protect the U.S. consumer and investor. The Sarbanes–Oxley Act simply does not provide many meaningful regulatory protections.⁴⁰²

(6) management functions or human resources;

(7) broker or dealer, investment adviser, or investment banking services;

(8) legal services and expert services that are unrelated to the audit

A compromise is apparent here, because the provision of tax services by audit firms was not prohibited, and tax services have long been a major source of income for audit firms, responsible for up to an estimated one third of audit firm revenues.

Id. at 5–6 (footnotes omitted).

399. *See supra* note 386 and accompanying text.

400. 28 U.S.C.A 1658(b) (West Supp. 2004).

401. *See supra* notes 129–30, 135.

402. *See supra* Part V.

A. Re-regulation Must Occur To Protect Investors and Ensure the Integrity of the Capital Markets

To begin, nearly every provision of the PSLRA should be repealed or softened and replaced with the common-sense regulations that were in place before the Revolution Congress descended upon Capitol Hill.⁴⁰³ Excruciating monthly reports detail the efforts of shareholders and employees seeking to sue Enron, WorldCom, Global Crossing, Tyco, and Adelphia for retribution, only to have most efforts stonewalled by the PSLRA.⁴⁰⁴ Not only has the PSLRA prohibited many shareholders from conducting preemptive suits against malfeasant companies,⁴⁰⁵ but the PSLRA has blocked aggrieved shareholders and employees from finding a deserved remedy from the criminally-charged and admittedly-guilty corporate executives.⁴⁰⁶ Inexplicably, Congress offers up SOX as the best that it can do. Congress must undertake to repeal much of the PSLRA, return the standards and regulations that the PSLRA stripped away, and further strengthen the ability for offended shareholders and employees to hold a corporation and its management responsible for egregious breaches of public trust perpetrated by such management.

Further buttressing the argument that the PSLRA was a short-sighted grab for favor and approval from corporate America by the 104th Congress, at the expense of the U.S. investor and U.S. worker, is a recently released exhaustive report entitled *What Works in Securities Laws?* and written “by a troika of Ivy League economists—Dartmouth’s Rafael La Porta, Yale’s Florencio Lopez De Silanes, and Harvard’s Andrei Shleifer.”⁴⁰⁷ The study seeks to identify the mark-

403. See *supra* sections II.A–C.

404. See Lerach, *supra* note 13, at 87–88.

405. See *supra* notes 135–59 and accompanying text (evaluating the PSLRA’s super heightened pleading standard).

406. See *supra* note 404.

407. Daniel Gross, *So Sue Me: What’s the Best Way To Punish Corporate Criminals? With Lawsuits, Not Prison Sentences*, SLATE MAG., Sept. 23, 2003, at <http://slate.msn.com/id/2088790>. “[A]ccording to [a] study by a troika of Ivy League economists . . . stockholders shouldn’t hunger for perp walk and criminal persecutions. In fact, markets develop better when civil—not criminal—law is strong.” *Id.* Gross, in introducing the study and its important results, reminds the U.S. investor that:

Sellers rip off buyers: This is a fundamental downside of capitalism. Governments have three ways to deal with it. They can do nothing and trust (or hope) that financial and reputation concerns will keep securities-selling executives on the straight and narrow. (How quaint.) Second, they can establish a regime of *private* enforcement. Governments establish securities laws that impose disclosure obligations on those who sell stocks to the public and then provide avenues—i.e., lawsuits and arbitration—through which wronged investors can try to recoup losses. The third approach is more explicitly statist: *public* enforcement. Instead of just promulgating rules and letting the private sector fight it

ers that establish the most efficient and productive worldwide capital markets:

In what must have been a heavy exercise in data-mining, the economists examined the 49 largest stock markets in the world, devised “quantitative measures of security laws and regulations” and indicators of stock market development, and then gauged the relationship between the two sets of variables: data such as the different kinds of liability regimes, the nature of securities enforcement agencies, and the number of domestic publicly traded firms in each country relative to its population. They used regression analysis to determine which variables correlate with more developed stock markets.

Their conclusion is surprising—and surprisingly practical. What works best, it turns out, is a combination of mandated disclosure (thus allowing the markets to work their efficient magic) and the ability of plaintiffs’ lawyers to sue the hell out of corrupt CEOs and underwriters.⁴⁰⁸

The study’s conclusion is that private lawsuits, combined with common-sense regulation and governmental control, is by far the most effective method to manage a national capital market.⁴⁰⁹ In 1995, the PSLRA effectively weakened one of those vital tools for investors—the private lawsuit brought by aggrieved U.S. investors. In light of the study *What Works in Securities Laws?*, it is little wonder that the markets collapsed once the private class action was severely constricted.

In 1994 with *Central Bank* and 1995 with the PSLRA, the Supreme Court and Congress respectively weakened substantially that vital tool for investors—the private lawsuit brought by aggrieved investors against secondary enablers.⁴¹⁰ In light of the study *The Effect of the Private Securities Litigation Reform Act of 1995 on Accounting Discretion of Client Managers of Big 6 and Non-Big 6 Auditors*,⁴¹¹ it is little wonder that the markets collapsed once the private class action against secondary actors was severely constricted.⁴¹²

out, governments create agencies, like the Securities and Exchange Commission—independent regulators with the power to investigate, prosecute, and fine. Many countries—including the United States—combine the second and third options.

Id.

408. *Id.*

409. See RAFAEL LA PORTA ET AL., WHAT WORKS IN SECURITIES LAWS?, NATIONAL BUREAU OF ECONOMICS RESEARCH WORKING PAPERS SERIES, WORKING PAPER NO. 9882 (July 2003) (“We examine the effect of securities laws on stock market development in 49 countries. We find almost no evidence that public enforcement benefits stock markets, and strong evidence that laws facilitating private enforcement through disclosure and liability rules benefit stock markets.”), available at <http://www.nber.org/papers/w9882>.

410. See *supra* note 320.

411. Lee & Mande, *supra* note 107.

412. See Steven A. Ramirez, *Fear and Social Capitalism: The Law and Macroeconomics of Investor Confidence*, 42 WASHBURN L.J. 31, 61 (2003) (“[I]t is critically important that not only companies, but associated professionals be held to account for securities fraud. The PSLRA specifically undercut the liability of such affiliated professionals.”).

To remedy this lapse in judgment, Congress should act quickly to repair the PSLRA damage and return the private class action against corrupt CEOs and underwriters to aggrieved investors.⁴¹³ Specifically, Congress must begin by rejecting the “super heightened” pleading standard instituted by the PSLRA⁴¹⁴ and replace the pleading standard with the already effective Rule 9(b) standard, as was required prior to passage of the PSLRA.⁴¹⁵ Congress must act affirmatively straightaway and acknowledge its deregulatory failure.

Legislation has been introduced in the House of Representatives to that end—the Shareholder and Employee Rights Restoration Act of 2003.⁴¹⁶ The bill should be given immediate attention and should be enacted with the haste and pomp that its predecessor, the PSLRA, was afforded. The appropriate pleading standard must be the Rule

413. On February 5, 2003, Representative Bart Stupak (D-Michigan) introduced a bill in the House of Representatives that seeks as its primary purpose “[t]o repeal the provisions of the Private Securities Litigation Reform Act and the Securities Litigation Uniform Standards Act that limit private securities actions, and for other purposes.” Shareholder and Employee Rights Restoration Act of 2003, H.R. 636, 108th Cong. (2003). Upon introduction, the bill that seeks to repeal each of the prohibitive provisions of the PSLRA was referred to the Committee on Financial Services and to the Committee on the Judiciary, “for a period to be subsequently determined by the Speaker, in each case for consideration of such provisions as fall within the jurisdiction of the committee concerned.” *Id.* The bill, as introduced, provides the following:

Shareholder and Employee Rights Restoration Act of 2003—Amends the Securities Act of 1933 governing private securities litigation to repeal: (1) certain limits on private class actions; (2) the safe harbor applied to forward-looking statements (corporate predictions); (3) proportionate liability of an outside director; and (4) specified limitations on class action remedies.

Amends the Securities Exchange Act of 1934 to repeal guidelines governing: (1) the safe harbor applied to corporate predictions; (2) limitations on class actions remedies; (3) court-ordered security for payments of costs in class actions; (4) motions to dismiss and stay of discovery; (5) sanctions for abusive litigation; (6) written interrogatories as to defendant’s state of mind; (7) limitation on damages; and (8) proportionate liability.

Modifies guidelines governing a securities fraud action to prohibit a complaint that is based upon information and belief from specifying the source of the facts upon which such belief is formed (thus granting whistle blower protection).

Amends the Securities Act of 1933 and the Investment Advisers Act of 1940 to establish liability for aiding and abetting securities violations.

Amends the Securities Exchange Act of 1934 to modify guidelines governing aiding and abetting.

Extends the statute of limitations for an implied private right of action to three years after the date on which the alleged violation was discovered.

Id.

414. *See supra* notes 129, 135.

415. *See supra* notes 160–62 and accompanying text.

416. *See* H.R. 636, 108th Cong. (2003).

9(b) heightened standard, which existed prior to passage of the PSLRA, where aggrieved investors would make colorable claims, become certified as a class, and be provided the opportunity, through discovery, to uncover further deceptions and corruption. Otherwise, neither Sarbanes–Oxley, nor the market crash of 2002, will dissuade corrupt corporate executives from attempting to further bamboozle U.S. investors.⁴¹⁷

Further, Congress should now remove the dangerous corporate-executive protections for forward-looking statements by repealing the rules that allow false statements to abide if accompanied by appropriate cautionary language, as originated in the PSLRA.⁴¹⁸ As discussed *supra*, the safe-harbor provision for forward-looking statements serves to shield issuers and management from private liability in connection with these false or misleading statements.⁴¹⁹ If an issuer accompanies its false or misrepresentative information with “meaningful cautionary statements,” then it will escape private liability under the revised securities laws.⁴²⁰ As eradicating liability for intentional false projections cannot square with the intent of the drafters of the federal securities laws in the 1930s, whose primary objective was to protect investors and to ensure that honest and straightforward information was being widely disseminated, Congress must act quickly to enact the Shareholder and Employee Rights Restoration Act of 2003.

Additionally, Congress must discard the nearly impossible aider-and-abettor standard articulated by the U.S. Supreme Court⁴²¹ and replace it with the prevailing U.S. Circuit Court interpretation that was in place prior to *Central Bank*.⁴²² In order for a plaintiff to now prevail in a private right of action under an aiding and abetting allegation, *Central Bank* requires a plaintiff to prove that the harm done by the aider and abettor was the “proximate cause” of a defendant’s fraudulent activity.⁴²³ This must be replaced with a “but for” requirement.⁴²⁴ Rejecting this “proximate cause” standard will make it much more likely that a victim of securities fraud will be able to hold responsible and liable other parties, apart from the issuer, that assist in the perpetuation of the corporate fraud—including underwriters, accountants, and law firms—which is precisely what is needed in this post-

417. See generally *supra* notes 407–12 and accompanying text (describing the *Securities Laws* study concluding that a combination of sensible federal regulation and the deterrence of private lawsuits is the hallmark for the most efficient worldwide capital markets).

418. See *supra* notes 172–73.

419. See *supra* notes 172–78 and accompanying text.

420. See *id.*

421. See *supra* note 197.

422. See *supra* note 200 and accompanying text.

423. See *supra* notes 197–204 and accompanying text.

424. See *id.*

2002 crash corporate world.⁴²⁵ Further, Congress must return the Rule 11 mandatory sanction provision back to the more appropriate standard enunciated in the Federal Rules of Civil Procedure, and Congress should repeal the drastic limitations it imposed on class-action remedies.⁴²⁶

The Revolution Congress sought to severely restrict private securities class-action lawsuits.⁴²⁷ That wrong must be rectified.⁴²⁸ To repair the damage caused by the PSLRA and to begin to heal the wounds inflicted upon U.S. investors by the Revolution Congress, Congress merely needs to act upon the proposed House of Representatives bill that seeks to repeal the PSLRA.⁴²⁹ Further, Congress simply needs to repeal the "super heightened" pleading standard, allowing securities fraud pleadings to default to Rule 9(b) requirements, which adequately protected corporate interests prior to 1995 and the PSLRA.⁴³⁰

B. To Those that Reject Federal Regulation as a Solution

While re-regulation may appear abundantly, even crystal, clear as a solution to those forces that caused the market crash of 2002, many in Washington, D.C. still maintain that re-regulation will hurt the country and the U.S. economy.⁴³¹ Despite those that cling to the idea

425. See generally *supra* notes 101–05 and accompanying text.

426. See *supra* notes 192–96 and accompanying text.

427. See *supra* note 139.

428. See generally *supra* notes 407–12 and accompanying text (describing the *Securities Laws* study concluding that a combination of sensible federal regulation and the deterrence of private lawsuits is the hallmark for the most efficient worldwide capital markets).

429. See *supra* note 413.

430. See *supra* subsection II.A.2.

431. See David Ho, *FCC Chief Says Move to Regulation Could Hurt Economy: Powell Decries D.C. "Mood Swing" in Aspen Speech*, DENV. POST, Aug. 18, 2003. Ho reports that:

Federal Communications Commission Chairman Michael Powell said today the threat of terrorism and the "despicable activity" of some companies has led to a shift toward more regulation that could harm innovation and the economy. "I do see a mood swing in Washington. I see a mood swing in the country," Powell said at the Aspen Summit, a technology and telecommunications summit held by the Progress and Freedom Foundation, a Washington think tank. Powell said he worries about the rising belief that regulations do a better job than free markets because "the telecommunications sector and the high-tech sector are at a point in history where they can ill afford to be lined up with that kind of thinking." He also said industry bears much of the blame. The litany of corporate fraud cases has undermined the public trust and generated support for more regulations.

Id. But see Morrissey, *supra* note 203, at 826–27 (disputing the notion that more regulation would harm the U.S. economy). Professor Morrissey points to a different cost analysis in connection with adoption of the PSLRA:

of deregulation in today's corporate climate, even leading administration officials acknowledge, however begrudgingly, that the public continues to cry out for protection from corporate malfeasors and from congressional enablers:

"The despicable activity engaged in by Enron and MCI and Adelphia—and the list is long—violates the trust of their employees, violates the trust of the market, violates the trust of consumers and people cry out to be protected," [FCC Chairperson Michael Powell] said. *Powell said the government must respond, but should avoid going too far.*⁴³²

Further, in recent election campaigns, in the face of the deregulatory disaster of the 1990s, holdovers from the Revolution Congress are still championing the importance of electing them so as to continue to deregulate crucial U.S. industries.⁴³³

C. Specific Regulations Must Be Adopted

As discussed in some detail previously, Congress must now be willing to adopt specific regulations in order to protect consumers, safeguard investors, and ensure that future market collapses, such as the

Commentators have widely described the passage . . . as a direct result of corporate lobbyists and the professionals who serve them persuading Congress that corporations were routinely being victimized by strike suits—frivolous law suits brought merely to force the corporations into extortionist settlements. . . .

While Congress was focusing its energies on putting an end to those strike suits, statistics pointed clearly to the opposite conclusion—that the value of the fraudulent schemes being committed and not subjected to litigation vastly outweighed the value of the supposed notorious strike suits threatening corporations.

Id. at 826; *see also* Stout, *supra* note 132, at 713–15.

432. Ho, *supra* note 431 (emphasis added).

433. *See* Jay Bookman, *Enron Just Tip of Corruption that Runs Deep*, ATLANTA J.-CONST., June 20, 2002, at 18A. Bookman reports that in Senator Bill Frist's (R-Tennessee) 2002 reelection campaign, Frist sought out corporate officers and lobbyists to remind them that in the wake of Enron, that GOP control of the Senate was critical to continuing to deregulate corporate America. *See id.*

Clearly, the accounting industry's system of self-regulation has been a dismal failure. However, efforts to reform that system have been blocked to date by Republican opposition in Congress. To understand why, consider a letter written by U.S. Sen., Bill Frist (R-Tenn.) inviting corporate officers and lobbyists to attend a GOP fund-raising dinner Wednesday night. In his letter, Frist reminded contributors that if the GOP regained Senate control, it was committed to "relax the stranglehold of rules, regulations and restrictions on American business."

Apparently that message went over well, since the dinner—highlighted by a speech by President Bush—raised well over \$28 million in soft money for the GOP.

Id. Inexplicable. In the face of Enron, Global Crossing, and with WorldCom just about to drop, Republican leadership, having deregulated industries to the point of market failure, were continuing to campaign to "relax the stranglehold of rules, regulations and restrictions on American business." Senator Frist, just 35 or so days later, voted to support enactment of Sarbanes-Oxley.

market crash of 2002, are not enabled by ill-conceived federal legislation. Specifically, Congress must set about to repeal large portions of the Private Securities Litigation Reform Act. Congress must also re-regulate certain sectors of the telecom industry, namely the cable television sector and the Internet region. Congress must also set about reexamining its Telecommunications Act enactments to determine where it failed in promoting and encouraging competition in the local telephone industry and the international carrier segment of the telephone zone. Additionally, Congress must examine its failings in enacting deregulating telephone legislation that enabled WorldCom, Global Crossing, and Qwest to deceive U.S. investors and perpetrate massive frauds upon the capital markets.

In addition, Congress must begin immediately to enact laws that will serve to regulate the trading of commodity derivatives, particularly the regulation of private corporations engaged in commodity futures trading.⁴³⁴ Congress should shoulder the responsibility of failing to heed the calls of those espousing regulation of the commodity futures trading market,⁴³⁵ realize the errors that allowed Enron, El Paso, and Dynegy to devastate the capital markets and the U.S. economy, and humbly enact regulation that will provide CFTC oversight of all commodity futures trading, particularly amongst private corporations that may use such speculative trading to hide massive losses and generate mythical revenues.⁴³⁶

VII. CONCLUSION

The Revolution Congress’s clarion call of “deregulation” and reform that accompanied the revolution class into power in 1995 is nothing now if not a faint reminder of the abject failure of most of the 104th Congress’s deregulatory efforts. A stark token of the 104th Congress’s efforts are: a telecommunications industry in chaos; collapsed U.S. capital markets that continue to struggle to right themselves, despite five years of Administration calls that all is well; a derivatives trading industry that enabled the greatest corporate collapse in U.S. history; disbelieving investors with no confidence in corporate executives; disenfranchised U.S. employees; a jobless rate that refuses to decline; and, absent the tragic distraction of 9/11, a complete joylessness in corporate, blue collar, and inner-city America.

Despite quick passage of the weak Sarbanes–Oxley Act, despite a war effort—that has traditionally been a harbinger of better economic times—despite continued assurance by politicians that the economy is

434. See *supra* section III.B. The need for regulating commodity derivatives will be detailed in a future article.

435. See *supra* notes 289–303 and accompanying text.

436. See *generally supra* sections VI.A–B.

improving, and despite the arrest and jailing of several of the corporate criminals implicated in the crash of 2002, things simply are still amiss. 1990s deregulation must be deserted. The PSLRA has failed to protect anyone, other than corporate malfeasors.⁴³⁷ The Telecommunications Act has failed to provide competition, jobs, and the promised economic upsurge. The CFMA, in a costly refusal to regulate has given the U.S. investor "Enron" as a common curse word for corporate excess and all that is wrong with current protections for corporations.⁴³⁸

The regulations that were abandoned a decade ago need to be returned to the citizens of the United States. The PSLRA must be rejected, so that private investors once again can wield a realistic sword of an impending class action against offending and offensive corporate executives. Certain of the repealed regulations under the Telecommunications Act must be returned—so that true competition can be generated between those monopolists in the industry—before any dream of true deregulation can be entertained. The commodity derivatives trading industry, particularly derivatives trading amongst private parties, must come under new regulation imposed through the Commodity Futures Trading Commission. Perhaps then will the pain of the market collapse of 2002 be averted in the future.

437. For an argument that the PSLRA has worked in a limited way, see Perino, *supra* note 121.

438. See Greenwood, *supra* note 82, at 774 (describing "Enronitis" as a new definition for corporate corruption.) Professor Greenwood writes:

Enronitis. (n., neologism derived from Enron, a large company that went bankrupt amid allegations of market manipulation, phony accounting, looting, and other corporate misbehavior)

1. A malfunction of corporate governance in which top managers become extraordinarily wealthy while misleading shareholders, creditors, employees and the general public about the company's prospects and practices, eventually resulting in share price collapse, loss of jobs, and, in extreme cases, the corporation's bankruptcy. . . . Often accompanied by sudden collapse of the reputations of seemingly upstanding corporate citizens who turn out to have been routinely lying, not only to shareholders, but to their own boards, employees, tax authorities, etc.

Id. at 774–75.